BULLETIN

RESERVE BANK OF NEW ZEALAND

WELLINGTON, N.Z.

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Note: Where figures are given to a certain degree of approximation the total shown may not be the same as the sum of the items.

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.. = not available.

— = nil or less than half the unit employed.

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Central Banking in New Zealand

II - THE HISTORY OF THE RESERVE BANK OF NEW ZEALAND

As early as 1886 proposals were made for either a central bank or a state trading bank in New Zealand. In 1913 it was proposed in Parliament that a Royal Commission should be formed to investigate the banking system with a view to nationalising the Bank of New Zealand or establishing a new central institution. The principal dissatisfaction with the then existing arrangements arose through the high level of interest charges. These early attempts either to modify the Bank of New Zealand or to create a separate central banking institution were ineffective. Banking problems were not raised, as a major issue, after 1913 until the depression of 1930 when the New Zealand Government invited Sir Otto Niemeyer, then conferring with the Commonwealth Government of Australia, to report on the Dominion's banking and currency system.

The Niemeyer Report on currency and banking gave the Government a basis on which to mould its ideas. Its text briefly surveyed the economy and contained recommendations about banking law and a draft of a Reserve Bank bill. The main provisions were:

(a) The establishment of a Reserve Bank which should be privately owned.
(b) The centralisation of the note issue in the Reserve Bank.
(c) The convertibility of New Zealand currency into sterling at a fixed rate of exchange.
(d) The trading banks should keep minimum reserves with the Reserve Bank of 7 per cent of their demand liabilities and 3 per cent of their time liabilities in New Zealand.

It was recommended that the business of the Reserve Bank should include the purchase and sale of New Zealand or British Government securities though the total long-term holdings should not exceed the paid up capital and reserves; the granting of advances for up to three months against specified collateral; and the usual facilities for discounting bills of exchange, etc. It was hoped that these provisions would be sufficient for the regulation of the banking system. Loans to the Government, Government undertakings, and public authorities were restricted to an estimated three months' revenue, and, in addition, it was suggested that the Reserve Bank should manage, but not underwrite Government loans.

Sir Otto Niemeyer was particularly concerned about the relationship between the Reserve Bank and the State. He said that the Bank must be entirely free from both the actual fact and the fear of political interference. For this reason he recommended that the capital of the Reserve Bank should be privately subscribed and Government influence in the internal administration limited to the approval of the appointment of the Governor and Deputy-Governor.

The Report was not acted upon immediately because of the serious depression then being experienced in New Zealand, and the fact that the role of a central bank was not understood by many people. It was not until 7th December, 1932, that the first Reserve Bank of New Zealand Bill was introduced into the House of Representatives. The Bill followed the Niemeyer Report but as there was intense controversy, especially on private ownership, it was decided to give further consideration to the proposed legislation.

The Establishment of the Reserve Bank

Discussion on the Reserve Bank proposal faded away at the beginning of 1933 because of more immediate exchange rate problems and the development of widespread unemployment; it was not until August that the proposal was proceeded with. Finally, in October a new Reserve Bank Bill was introduced into Parliament. The changes made in this Bill from the one introduced in 1932 show the extent to which the demands for State ownership and control of the central bank had influenced the Government; these demands came not only from the Labour Party in opposition but also from a section within the Government. The number of directors was increased from five to seven, of whom three were to be appointed by the Governor-General in Council; in addition the Secretary to the Treasury was to be a non-voting member. The dividend payable to shareholders was reduced to 5 per cent and the number of shares to be held by any one person was limited. The salaries of the Governor and Deputy-Governor were to be fixed by the Governor-General in Council and not by the Board as was originally proposed. The maximum accommodation which Treasury could obtain was increased to one-half of the annual revenues.

The business of the Reserve Bank was strictly defined. When Sir Otto Niemeyer presented his report, he suggested that the exchange rate should be fixed by statute. Circumstances changed, however, when the exchange rate was altered in 1933 so that provision was made for the Reserve Bank to fix the rate at which it would exchange New Zealand currency for sterling. The Reserve Bank could discount bills of exchange though a restriction was placed upon the categories of bills to be held and, similarly a limit was placed on the value of long-term British and New Zealand Government securities which could be purchased by the Bank. By operating in the securities market, by discounting bills, and fixing the exchange rate the Reserve Bank would be able to exert a significant influence upon monetary conditions in New Zealand.

Under this constitution the Reserve Bank of New Zealand opened for business in August, 1934.

Nationalisation

The first legislative act of the Labour Government in office was a fundamental amendment of the Reserve Bank of New Zealand Act. Private ownership of the Bank was abolished and the directorate was reconstituted so that all new appointments were made by the Governor-General in Council. Such a change must have been expected in view of the Labour Party's opposition to the 1933 Act. Amendments to the

clauses relating to the lending powers and the business activities of the Bank disclosed the administration's intentions to make use of the Reserve Bank's facilities for the support of its policies.

Whereas the 1933 Act set out the general duty of the Reserve Bank as the control over monetary circulation and credit in New Zealand for the promotion and maintenance of the economic welfare of the Dominion, the 1936 Amendment made the important alteration that the general function of the Bank was

"to give effect as far as may be to the monetary policy of the Government, as communicated to it from time to time by the Minister of Finance. . . ."

For this purpose and the promotion and maintenance of the economic and social welfare of New Zealand, the Bank was required not only to regulate and control credit and currency in New Zealand but also foreign exchange transactions and the disposal of export proceeds. To enable the Bank to fulfil these functions, it was laid down that the Governor-General in Council could make such regulations as were thought necessary.

Former restraints upon the Government's use of Reserve Bank credit were relaxed. Advances to the Government or any board or authority for financing the purchase and sale of primary produce were permitted; this innovation was a portent of the various marketing schemes introduced later in 1936. The limit on short-term accommodation which could be granted to the Treasury was raised to the total estimated annual revenue. The Bank was authorised to underwrite Government loans; previously, it could only manage such transactions. In the light of later events the inclusion in the Act of a clause authorising the Minister to suspend the Bank's obligation to sell sterling on demand was one of the most far-reaching changes brought down in the new legislation.

The power of the Reserve Bank to influence internal monetary conditions was greatly enhanced by the amendment which authorised the Governor, acting with the authority of the Minister of Finance, to vary the balances which trading banks must keep with the Bank. Although most of the former limitations upon the purchase of securities and the discounting of bills were removed or relaxed, the absence of a developed money market severely restricted the use of these methods of affecting the supply of credit in the economy. But by raising or lowering the required balances the Bank could reduce or add to, the trading banks' excess cash balances and so influence the expansion of credit.

Amendments in 1939

There was little further change in the constitution of the Bank after the 1936 legislation. In 1939, however, the authority of the Minister of Finance in relation to the Bank's activities was amended by the addition of the following:—

"The Governor and the Board of Directors shall have regard to any representations that may be made by the Minister of Finance in respect of any functions or business of the Reserve Bank and shall give effect to any decision of the Government in relation thereto conveyed to the Governor in writing by the Minister of Finance."

Another important change made at the same time was the section empowering the Minister of Finance to suspend indefinitely the requirement made upon the Bank to keep a minimum reserve, mainly gold and sterling exchange, of 25 per cent of the aggregate amount of its notes in circulation and other demand liabilities. In previous legislation it was permissible for the Minister to suspend this requirement for a period of up to thirty days and this could be renewed at the request of the Board.

Conduct of business had been strictly defined in the original Act so that it was not lawful for the Bank to engage in trade, to make unsecured loans or advances, or to undertake certain other activities. Such restraint was relaxed by a clause which authorised exceptions to be made to these limitations subject to the authority of the Governor-General in Council.

Recent Legislative Changes

During the war and immediate post-war years some minor alterations were made to Reserve Bank legislation. For example, in 1946 the Bank was authorised to grant overdraft accommodation to the Government for general purposes provided that the total overdraft did not exceed the amount of investments held by the Treasury. In 1950, however, there was a further major modification to the legislation.

As outlined above the 1939 amendment empowered the Minister of Finance to issue directives to the Reserve Bank on any aspects of central banking practice or policy. This section was repealed in 1950, and in its place it was stated that the Reserve Bank should give effect to any resolutions of the House of Representatives in respect of any of its functions or business.

At the same time the requirement that the Bank should hold a minimum reserve equal to 25 per cent of notes in circulation and other demand liabilities was abolished. In place of this obligation the Bank was required to maintain a reserve which in the opinion of the Board of Directors would provide a reasonable margin for contingencies. The idea behind all reserves is that they form a fund for emergency use. Yet when a central bank is required to keep a minimum percentage reserve these assets are legally "frozen" at a time when they are most needed. Usually provision is made for the reserve to be suspended. But if such action is adopted in an atmosphere of crisis, as it is generally, it is almost certainly harmful to confidence and thereby aggravates the difficulties of the situation. While it is not desirable to run down basic foreign currency reserves, it is essential that the size of reserves should be adaptable to changing circumstances. Generally speaking it should be the aim in times of high export prices to build up overseas reserves which can be used when export prices are lower.

In the Reserve Bank Amendment Act 1950 the statement of objectives towards which the Bank must direct its policies was amended to include the need for the highest degree of production, trade, and employment that can be achieved by monetary action and the promotion and safeguarding of a stable internal price level. It is not intended to suggest that the Bank's monetary action alone could achieve these objectives. The section states that, within the limits of its powers, the Reserve Bank shall do all such things as it deems necessary or desirable to attain these objectives.

Recent Monetary Changes in New Zealand

Volume of Money

FOR THE FIRST TIME SINCE THE DEPRESSION the upward trend in the volume of money has ceased in New Zealand and there was a decrease of about £13½ million during the year ended March, 1952. The peak was reached at the end of March, 1951, at a level of £291 million. At the same date in 1952 the figure was £277.5 million, and at the end of April, 1952, was £269.7 million. The decline is not very large, but the change of trend after such a long period of regular and sometimes substantial increases is significant. In the past year (to March, 1952) there has been an increase of more than £54 million in trading bank advances and, other things being equal, this would have caused an equivalent increase in the money supply. In spite of this there has been a decrease, and the factors causing it have been the adverse change in overseas reserves during the March year (£21 million), the repayment of Government indebtedness to the Reserve Bank (£27 million) and the transfer of wool retention money into frozen accounts (£14 million). Thus the effect of the high level of bank advances has been more than offset by these other changes.

Velocity of Circulation

The average velocity of circulation of bank deposits, which had dropped by 1946 to little more than half the 1938 level and thereafter was rising slowly, has in recent months begun to increase at a faster rate. This is shown in the following table:

INDEX OF VELOCITY OF CIRCULATION
(Base: 1938 = 100)

Annual average			
1946	51	1949	57
1947	59	1950	64
1948	59	1951	67
Monthly			
1951—February	68	1952—February	78
March	72*	March	89*
April	66	April	71

* Seasonal peak.

Bank Overdrafts

Bank overdrafts reached a record level during March and April, 1952. In the past year or so almost all classes of borrowers have increased their overdrafts, although farmers show very little increase. The chief borrowers have been the importers, the retailers and the manufacturers, for the purpose of financing greater stocks of goods. The flood of imports which has come into the country in the last nine months had to be financed once commitments had been entered into, and the only way to do it in the short run was by means of bank overdraft. There is also a long-term trend upwards in overdrafts and that is natural in view of the steadily rising population, the high level of incomes and prices, and the increasing volume of business. For example, the total recorded value of exports and imports in 1951 was £455 million, compared with £114 million in 1938. The present figure of about £190 million for total bank overdrafts is not significantly larger in relation to the national income than it was before the war, but it is too large relative to production, labour supply and real resources.

Measures designed to place restraint on bank lending have been progressively intensified since the end of 1950, but it will take some time before this shows its full effect. March is normally a peak period in bank advances and a decline should occur during the next few months.

Government Debt to the Reserve Bank

Total Government borrowings from the Reserve Bank, as indicated by the value of Government securities held by the Bank, reached a figure of £92 million in January, 1950. The latest available figure is £50 million—a very substantial reduction.

Trading Bank Deposits at the Reserve Bank

These deposits represent the major part of the cash reserves of the trading banks. When the Reserve Bank was established in 1933 it was stipulated that the trading banks should maintain deposits at the Reserve Bank equal to not less than 7 per cent of their demand liabilities in New Zealand plus 3 per cent of their time liabilities in New Zealand. The purpose was to ensure that the trading banks always kept a minimum amount of cash to meet the needs of their customers, to ensure that there would be a means for clearing cheques between the banks, and to give the Reserve Bank a method of controlling the credit policies of the trading banks. It was provided that those percentages could be increased from time to time by the Governor of the Reserve Bank acting with the authority of the Minister of Finance. The actual level of the deposits held by the trading banks depends on a number of factors, for example, they are increased by disbursements from Government accounts and from the accounts of the Marketing Department and the various marketing organisations such as the Meat Board and the Dairy Products Marketing Commission. They are increased also when the trading banks sell used notes back to the Reserve Bank for cancellation and destruction, or if the trading banks sell sterling to the Reserve Bank, or if the trading banks borrow from the Reserve Bank. On the other hand they are reduced when taxation and other revenue is paid to the Public Account, or when the trading banks buy sterling or dollars from the Reserve Bank, or when the trading banks buy new notes from the Reserve Bank.

In recent years, because of the tendency for surpluses to be greater than deficits in our external transactions, and because of the large increase which occurred in Government borrowing from the Reserve Bank during and after the war, the deposits of the trading banks at the Reserve Bank have been vastly in excess of the statutory minimum. They have been as high as £89 million and have been seldom below £60 million in the last few years, whereas the statutory minimum has risen only very gradually to a level of about £15 million. At the end of September, 1951, the deposits amounted to £84.6 million. At the end of March they were down to less than £25 million and have since recovered to £33 million at the end of April.

Any expansion of bank credit tends for various reasons to reduce the margin between the actual and the minimum deposits of the trading banks at the Reserve Bank. The smaller the margin the greater the caution that needs to be exercised in conducting their lending policies, and the greater the need for adherence to reduction programmes of existing overdrafts.

Balance of Payments and Net Overseas Assets

The balance of payments problems which are being experienced at present were caused basically by monetary expansion, but have been accentuated in the past two years by the following factors:—

(a) The high wool prices of the 1950-51 season created a feeling of great prosperity in the country, boosted incomes, and caused importers to anticipate the continuation of a sellers' market for some time to come. The demand for imports was thus very high.

(b) From the beginning of 1951 a considerable portion of total imports was freed from licensing control.

(c) Because of progress in productivity in the United Kingdom and elsewhere, and particularly because of some small business recession in sterling countries, the availability of imported goods improved very rapidly in 1951 and the beginning of 1952, and goods were delivered much sooner than was expected.

(d) The price of imports has been rising steadily and quite significantly in the past two years so that we have to spend more overseas funds to obtain the same volume of imports.

(e) Since March, 1951, wool prices have dropped by more than 75 per cent and export receipts are very much lower than they were a year ago.

Changes in wool prices are now the largest single factor determining changes in the amount New Zealand can afford to spend on imports. For 1952 wool receipts will be down to about £60 million, a drop of £65 million from last year. If no special action were taken to remedy the situation private imports in 1952 would have been at least £200 million and perhaps more, so that there would have been a deficit of between £40 and £50 million pounds which would have had to be financed out of reserves. At the beginning of the year those reserves were about £80 million.

The extent of our excessive importations over the past nine months can be shown by reference to the monthly figures relating to payments for private imports:—

PRIVATE IMPORTS

(£ million)

Annual average	
1949	9.1
1950	11.7
1951 (1st half)	12.4

Monthly			
1951—July	14.1	1952—January	24.0
August	19.9	February	23.1
September	20.8	March	20.9
October	25.4	April	18.2
November	24.6		
December	22.4		

In the first quarter of 1952 New Zealand imported £68 million worth of goods, or an annual rate of £272 million. That rate of imports would not be continued even if no special action were taken, but in the meantime the drain on reserves would be much greater than New Zealand could afford. This is why the Reserve Bank (a) placed a limit on overdrafts to importers in December, 1951 (see December "Bulletin"); and (b) introduced, as from 1st April, 1952, a system of exchange allocation for imports (see April "Bulletin").

Motor-Car Imports

On 11th March, 1952, the Prime Minister announced that "the importation of motor vehicles from all countries is brought under import control. After the Board of Trade has reviewed the whole of the motor-car import trade, the Government will determine the quantity and the sources of future vehicle supplies in consultation with the Board of Trade, and with the Customs Department, which will be the licensing authority". Thus after a license-free period of thirteen months, motor-car import licensing has been re-imposed.

In December, 1938, the net overseas funds of the Reserve Bank and the trading banks having declined to £N.Z.7.6 millions, the Government introduced regulations whereby all imports, including motor-cars, were to be subject to licenses issued by the Minister of Customs. There were two six-monthly licensing periods in 1939. The approved licenses for cars were for a percentage of the C.I.F. & E. value (cost, insurance, freight and exchange value or the total expense of landing a car) of the motor-cars imported in the corresponding period of 1938. By limiting imports to C.K.D. (completely knocked down or unassembled) vehicles, more motor-cars were obtained with the available overseas funds and the erection of automobile assembly plants was stimulated.

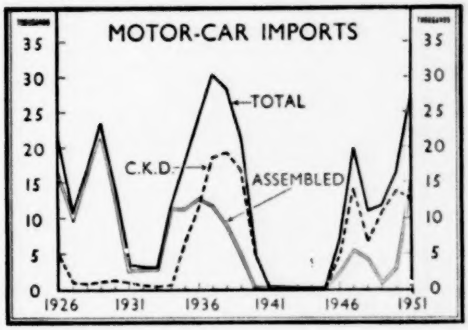
Very few licenses were issued for cars for civilian use from 1st July, 1940, until January, 1945, when cars from the United Kingdom could be imported. In 1946 and 1947 licenses were also approved for importing a limited number of cars from Canada and the United States. In 1948, however, when the dollar problem became more difficult, licenses were reduced whilst the import of cars from the United States was more severely curtailed. Licenses for British cars were increased in 1949 while the quota for Canadian cars remained unaltered. In 1950 no licenses were granted for cars from Canada.

On 9th March, 1950, the Government announced certain amendments to the exchange control regulations in force in New Zealand. These included approval of the taking, transfer, or sending of sterling

area securities from New Zealand without reference to the Reserve Bank, and an amendment that allowed holders of sterling area currency or securities to sell, transfer, change or otherwise deal with them without obtaining the prior consent of the Reserve Bank. Two months after this announcement, the Minister of Customs announced, on 17th May, the introduction of "no-remittance licenses whereby the holder of private funds in the sterling area may use them for the purpose of importing goods, for which, in general, ordinary licenses were granted, such as motor-cars, etc." (Details of this statement were given in the "Statistical Summary", May, 1950). The increased volume of motor-car imports in 1950 and 1951 indicated the substantial number of cars brought into New Zealand with these licences.

It was announced on 9th February, 1951, that cars imported from soft currency areas were free of license so that the need for no-remittance licenses for cars disappeared. Cars from Canada and the United States, of course, were still subject to licenses on an undisclosed basis.

The graph on this page shows the number of motor-car imports for the years 1926 to 1951 and the table shows their value and countries of origin. It can be seen that car imports fell sharply between 1931 and 1934 and again in the war years. The peak year was 1937, the one preceding the imposition of import control. As an item in New Zealand's balance of payments, motor-car and commercial vehicle imports for the years 1946 to 1950 averaged 5 per cent of the value of total imports as compared with 9.3 per cent in the years 1934 to 1938. The provisional figures for 1951 suggest a substantial increase in this percentage. The percentage of C.K.D. cars to total car imports in the years 1935 to 1939 was 36.7, 47.8, 61.3, 68.2, 78.0, and in the years 1947 to 1951, 72.3, 61.6, 93.4, 83.5, and 47.6 respectively. The decrease in 1948 was caused by the reduction of import licenses whilst the great increase in 1951 is attributable to the cars imported into New Zealand under the no-remittance licensing system.



MOTOR-CAR IMPORTS*: 1926-1951

Year	NUMBER							VALUE† £N.Z.000
	Country of Origin					C.K.D.	Assembled	
	U.K.	U.S.A.	Canada	Other	TOTAL			
1926	2,312	10,391	7,209	515	**20.427**	4,551	15,876	**3,080**
1927	2,128	6,122	2,336	285	**10,871**	852	10,019	**1,663**
1928	2,364	9,227	4,783	130	**16,504**	614	15,890	**2,336**
1929	4,064	8,529	10,740	28	**23,361**	938	22,423	**3,408**
1930	3,411	2,957	7,932	14	**14,314**	1,076	13,238	**1,996**
1931	2,414	475	482	17	**3,388**	795	2,593	**482**
1932	2,537	146	358	3	**3,044**	395	2,649	**421**
1933	2,272	190	470	1	**2,933**	207	2,726	**384**
1934	5,654	3,778	2,315	—	**11,747**	489	11,258	**1,819**
1935	9,668	5,530	2,618	—	**17,816**	6,537	11,279	**2,717**
1936	13,321	6,335	4,571	1	**24,228**	11,595	12,633	**3,558**
1937	18,083	4,851	7,398	3	**30,335**	18,596	11,739	**4,720**
1938	17,630	2,716	7,735	297	**28,378**	19,366	9,012	**4,506**
1939	13,112	983	7,323	100	**21,518**	16,785	4,733	**3,542**
1940	4,828	179	31	2	**5,040**	4,967	73	**746**
1941	221	6	1	2	**230**	212	18	**42**
1942	39	4	1	2	**46**	30	16	**10**
1943	—	—	—	—	—	—	—	—
1944	2	1	—	—	**3**	—	3	**1**
1945	43	5	3	—	**51**	—	51	**14**
1946	6,022	198	993	—	**7,213**	4,902	2,311	**2,034**
1947	13,685	992	4,693	2	**19,372**	14,030	5,242	**5,931**
1948	9,756	89	1,147	1	**10,993**	6,770	4,223	**3,778**
1949	10,254	76	1,429	5	**11,764**	10,987	777	**3,182**
1950	16,435	70	51	13	**16,569**	13,837	2,732	**4,723**
1951**	24,956	474	1,433	36	**26,899**	12,798	14,101	**9,880**

* Includes fully assembled, C.K.D. and chassis. † Current domestic value in country of origin plus 10 per cent. ** Provisional.

Current Notes

Balance of Payments

For the twelve months ended 31st March, 1952, a deficit of £16.4 million was recorded in New Zealand's exchange control transactions, receipts totalling £277.5 million and payments, £293.9 million. The 1951-52 March year deficit compares with surpluses of £23.3 million for 1950-51 and £0.5 million for 1949-50.

To the total receipts figure of £277.5 million ex-

ports contributed £251.6 million, including wool, £115.9 million; butter, £50.7 million; cheese, £17.0 million; and meat, £30.7 million. Export income suffered through the postponement of wool auctions from February to August, 1951, on account of the waterfront dispute. This prevented the Dominion from being able to take advantage of prices ruling in April and May, which were considerably higher than those in August, when wool sales were resumed.

Import payments in 1951-52 totalled £252.6 million, £21.7 million of which were on Government account. Private imports, at £230.9 million, were the highest ever recorded for a March (or a December) year. The greater part of private import payments occurred during October-March when they averaged a monthly rate of £23.4 million, as against £15 million in the previous six months. In the absence of the waterfront dispute, it is likely that the rise in payments for imports, in addition to taking place earlier, would have been more gradual with a more evenly smaller margin between the average monthly rate for these half-yearly periods.

"Invisible" (i.e., non-trade) receipts and payments followed their customary pattern, the former totalling £25.9 million and the latter, £41.3 million. The excess of £1.0 million in import payments over export receipts was thus augmented by a deficit of £15.4 million in "invisible" items, resulting in the overall deficit for the March year, as already stated, of £16.4 million.

Meat Production

Figures covering meat killings for export for the first six months of the 1951-52 season have been released by the New Zealand Meat Producers' Board. The total tonnage figure at 212,046 tons which was almost 35 per cent above that of the corresponding period in the 1950-51 season was nevertheless more than 12 per cent below that of the same period in the 1949-50 season. The 1950-51 season's killings of sheep and lambs were unusually low because of the abnormally high level of wool prices and the good pasture growth.

The accompanying table shows killings for export by principal classes for the first six months of the current season compared with the preceding two seasons.

(tons) **MEAT KILLINGS FOR EXPORT**

Class	1949-50	1950-51	1951-52
Lambs	146,676	111,645	132,427
Wethers	11,688	2,602	14,273
Ewes	40,213	21,879	42,112
Quarter Beef	14,100	2,077	5,128
Boner Beef	9,071	7,530	6,239
Pig Meats	9,677	5,836	4,087
Other	9,898	5,854	7,780
Total for Six-months Period	**241,323**	**157,423**	**212,046**

Meat Agreement

Following outbreaks of foot and mouth disease in Canada and the consequent ban imposed by the United States on imports of Canadian livestock and meats, an agreement has been concluded between the Governments of the United Kingdom, Canada and New Zealand, which provides for the diversion of New Zealand beef and pork, normally supplied to the United Kingdom under bulk-purchase contracts, to markets in the United States. Canada's beef and pork is to be shipped to the United Kingdom where outbreaks of the disease have also occurred and where no ban exists.

Wool Sales

The first sale of the calendar year 1952 was held at Wanganui on 11th January. The average overall price at the sale of 44 pence per lb. was some 12 per cent below that of the opening sales of the season in November, and a little easier than prices ruling before the Christmas break. At subsequent sales the average price fluctuated about this point but from mid-February a recession set in and prices fell with each successive sale, until at Invercargill on 31st March they reached the lowest point recorded for the season so far. The average overall price at this sale was slightly over 27 pence per lb. which was a little above the average price for the 1948-49 season's clip. Since then the trend of prices has been upward but when the season's sales ended on 3rd May they were still about 25 per cent below the January level and 35 per cent below the opening prices for the season.

The New Zealand Wool Commission, which came into operation on 1st January, 1952, and which operates the minimum floor price scheme for wool, has been represented at each sale this year. The Commission supported the market for some classes at Timaru on 27th March and also at subsequent sales but its actual purchases have been small.

Demand at the sales has come mainly from Bradford and the Continent with America and Japan in the market for specialty lots, notably coarse crossbreds. A feature of the sales since mid-February has been the comparatively few purchases by local mills.

Unfavourable climatic conditions have adversely affected the general quality of the offerings at all sales and most clips have been below the standard of recent seasons.

New Zealand and the Colombo Plan

The six-year Colombo Plan for co-operative economic development in the South and South-east Asian countries of India, Pakistan, Ceylon, Malaya, North Borneo and Sarawak commenced officially on 1/7/51.

The Plan consists of two parts. The first part is an economic development programme made up of numerous projects covering broadly the fields of transport, communications, agriculture, health, housing, education, industry, mining, fuel and power. The total cost of all the development projects is estimated to be £1,868 million of which £1,084 million is expected to come from sources outside the area. The second part is a scheme for technical co-operation, including the provision of consultants, the establishment of training institutions, and the financing and training of personnel from South and South-east Asian countries. About £8 million will be spent for this purpose by the Commonwealth Governments in the first three years.

New Zealand is providing both economic and technical assistance for the Plan. Between 1950 and 1953 the Dominion has offered to contribute £3 million for economic development, and £400,000 for technical assistance. Of the first year's portion of £1 million for development purposes, £750,000 has been allocated in equal amounts to Pakistan, India and Ceylon, and

the balance of £250,000 is held in reserve. Pakistan has received its allocation of £250,000 to assist the establishment of a pool of earth-moving and other equipment for use in constructing irrigation and flood control schemes; India's allocation is being used towards the cost of the proposed All-India Medical Research Institute (for which New Zealand has offered £1 million); and Ceylon's £250,000 will contribute to the cost of buildings and equipment for the expansion of the Dry Farming Research Station at Maha Illuppullama.

Some sixty representatives have come to New Zealand from Colombo Plan countries to receive training, and to study New Zealand conditions and institutions, while the Dominion has also sent several experts overseas in its technical assistance programme. Up till 31st March, 1952, about £20,000 had been spent on technical assistance, but the rate is to be accelerated.

Retail Trade (Wellington Area)

Although the monthly value of retail sales in the Wellington area has continued to increase since January, this is no more than a seasonal movement, as sales in February, March and April were below the levels of last year. Household drapery has been affected more than other lines covered by the survey. Clothing and furniture and furnishings sales also have been consistently lower than a year earlier.

March was the first month since November, 1951, in which the value of stocks did not decline. Stocks are now valued at about 20 per cent above last year's levels. The most recent figures are as follows:—

SALES, 1952
(Percentage changes in value compared with the same month of previous year)

COMMODITY GROUP	Jan.	Feb.	Mar.	Apr.
Men's and Boys' Wear	+ 18	− 8	− 11	− 6
Women's, Girls' & Infants' Wear	+ 17	− 9	− 12	− 1
Household Drapery	− 31	− 25	− 26	•
Footwear	+ 4	+ 7	− 3	− 3
Furniture & Furnishings	− 4	− 11	− 7	•
Household Appliances	+ 63	− 5	+ 8	+ 10
Radios	− 19	− 15	+ 30	− 31
All Groups	**+ 11**	**− 6**	**− 8**	**− 5p**

STOCKS, 1952
(Percentage changes in value compared with the same month of previous year)

COMMODITY GROUP	Jan.	Feb.	Mar.	Apr.
Men's and Boys' Wear	+ 25	+ 22	+ 19	+ 17
Women's, Girls' & Infants' Wear	+ 32	+ 6	+ 2	+ 10
Household Drapery	+ 31	+ 54	+ 53	•
Footwear	+ 7	+ 8	+ 5	+ 7
Furniture & Furnishings	+ 176	+ 111	+ 91	•
Household Appliances	− 16	+ 39	+ 49	+ 89
Radios	− 21	+ 1	+ 28	•
All Groups	**+ 28**	**+ 24**	**+ 20**	**+ 21p**

• Reports do not so far constitute an adequate sample, but are included in the "All Groups" figure. p Provisional.

House Building Costs

An index of house building costs for the Greater Wellington area has been made available by the Wellington Branch of the New Zealand Institute of Valuers.

The series is constructed from an analysis of a sample of contracts awarded for building various types of houses in the area. Each contract price is adjusted to an estimate of what it would have cost to build a "model" house of 1,000 square feet floor space and which contained only standard fittings. The cost of building a "model" house is calculated separately for Wellington City, the Hutt Valley and the Outer Suburbs. The three estimates are combined to form the index for the Greater Wellington area.

INDEX OF HOUSE BUILDING COSTS
(Base: December, 1942 = 100)

Calendar Year		Monthly	
1940	83.6	1951—January	160.6
1941	87.3	February	163.0
1942	94.5	March	164.5
1943	106.4	April	167.3
1944	112.7	May	167.3
1945	118.0	June	170.9
1946	127.0	July	172.7
1947	136.4	August	177.8
1948	142.7	September	177.8
1949	147.2	October	182.3
1950	151.6	November	187.2
1951	173.6	December	192.1
		1952—January	193.6
		February	193.3

United Kingdom Balance of Payments

In 1951 the United Kingdom balance of payments with all countries showed a deficit of £521 million, compared with a surplus of £244 million in 1950. The principal cause of the change was the large increase in the price and value of imports. Details are shown below:—

UNITED KINGDOM BALANCE OF PAYMENTS
(£stg. millions) *Source: U.K. White Paper, Cmd. 8505.*

	1948	1949	1950	1951
Exports	1,588	1,820	2,225	2,708
Imports	1,791	1,974	2,372	3,497
VISIBLE BALANCE	− 203	− 154	− 147	− 789
Invisible Receipts	655	704	929	1,014
Invisible Payments	478	545	538	746
INVISIBLE BALANCE	+ 177	+ 159	+ 391	+ 268
TOTAL BALANCE	**− 26**	**+ 5**	**+ 244**	**− 521**

Sterling Balances

The following table shows the changes which occurred during 1951 in the sterling balances held by various groups of countries:—

STERLING BALANCES
(£stg. millions) *Source: U.K. White Paper, Cmd. 8505.*

NON-STERLING AREA COUNTRIES	31/12/49	31/12/50	30/6/51	31/12/51
Dollar area	31	79	73	38
Other Western Hemisphere	80	45	55	57•
OEEC Countries	439	395	422	409†
Other non-sterling countries	514	492	518	514§
Total non-sterling countries	1,064	1,011	1,068	1,018
STERLING AREA COUNTRIES				
Dependent overseas territories	583	754	908	964
Other sterling area	1,770	1,978	2,192	1,825
Total sterling area countries	2,353	2,732	3,100	2,789
TOTAL ALL COUNTRIES••	**3,417**	**3,743**	**4,168**	**3,807**

† Largely in unofficial hands so that if sterling made convertible the drain might be very large.
• Mainly blocked holdings of Brazil and Uruguay.
§ Includes £200m. of blocked Egyptian balances and about £100m. of unblocked Japanese balances.
•• Excludes sterling liabilities to international organisations such as I.M.F.

I—RESERVE BANK OF NEW ZEALAND

Liabilities and Assets

(£N.Z. thousands)

Average of Weekly Figures:	LIABILITIES					ASSETS							
	Bank Notes	Demand Liabilities				Reserve			Invest-ments	Advances to State		Other Advances and Discounts	Other Assets*
		State	Banks	Wool Retention Account†	Other	Gold	Sterling Exchange	Other* Exchange		Market'g Orgns.	Other		
1945	41,123	12,228	43,972	—	1,012	2,802	60,064	—	11,797	2,085	24,163	—	1,455
1946	45,169	17,302	59,731	—	524	2,802	81,332	—	5,991	961	35,127	—	1,396
1947	47,682	13,265	57,102	—	483	2,802	85,300	—	4,576	1,157	28,510	5	1,046
1948✱	48,930	13,228	57,706	—	380	2,802	65,090	—	10,496	1,698	35,182	2,437	7,549
1949	51,312	11,384	73,837	—	355	3,223	48,995	—	41,855	3,482	37,628	4,907	1,973
1950	55,126	15,446	74,239	117	1,115	4,269	51,319	256	31,313	5,096	52,245	5,378	2,277
1951	60,361	18,844	69,326	4,204	725	5,139	62,557	383	27,107	3,379	51,134	6,829	3,224
Last Wednesday in Month:													
1951—May	58,413	10,544	75,902	1,238	4,718	5,071	73,802	170	10,974	5,842	50,694	6,832	4,174
June	59,804	11,589	73,694	2,879	1,913	5,157	78,120	419	7,974	4,033	50,000	6,495	3,714
July	60,624	9,874	75,294	4,882	719	5,203	78,483	460	11,974	1,929	50,000	6,235	2,949
Aug.	60,374	14,183	81,660	5,024	444	5,306	79,164	524	22,675	1,300	50,146	6,019	2,585
Sept.	60,566	12,173	84,617	1,494	604	5,365	68,213	457	31,440	1,419	50,040	6,019	2,423
Oct.	61,298	13,744	79,248	882	292	5,418	59,003	358	36,132	1,373	50,000	6,019	3,097
Nov.	64,576	12,268	69,737	361	470	5,451	38,602	437	46,182	1,541	52,986	6,019	2,365
Dec.	69,366	9,975	65,896	34	191	5,506	29,131	400	54,182	2,586	50,000	6,019	4,069
1952—Jan.	63,837	12,256	62,841	61	299	5,578	22,620	1,467	54,182	2,774	50,000	6,019	2,974
Feb.	62,217	22,149	54,396	—	687	5,638	19,786	1,566	54,182	4,805	50,012	6,019	4,023
Mar.	62,205	33,605	24,643	—	604	5,714	21,756	510	34,182	6,321	50,000	6,019	3,215
Apr.	62,600	22,235	33,210	—	529	5,749	23,019	406	32,182	5,985	50,000	6,019	2,416
May 7	61,851	22,397	32,908	—	531	5,772	24,800	283	32,182	3,988	50,000	6,019	1,870
14	62,256	18,986	35,273	—	248	5,838	24,940	322	32,182	2,821	50,000	6,019	1,950
21	61,861	18,426	38,216	—	428	5,847	25,002	611	32,182	5,049	50,000	6,019	1,657
28													

✱ On and after 20th August, 1948, overseas assets and liabilities converted to N.Z. currency at rate, £Stg.100 = £N.Z.100; previously £Stg.100 = £N.Z.124.
* Prior to 1950 the figures for "Other Exchange" are included under "Other Assets".
† Held temporarily pending transfer to Wool Rentention Accounts at trading banks. See text page 19 of February, 1951, issue.

II—NEW ZEALAND SILVER† COIN IN CIRCULATION*

Value by Denominations

(£N.Z. thousands)

Average of Quarterly Figures:	2/6	2/-	1/-	6d.	3d.	Total
1945	873	804	422	312	376	2,787
1946	937	872	452	337	419	3,016
1947	956	900	471	361	457	3,145
1948	971	911	479	377	480	3,218
1949	971	929	491	398	492	3.281
1950	993	957	514	432	528	3,424
1951	1,019	986	547	467	581	3,600
Quarter Ended						
Mar., 1951	1,004	955	534	449	553	3,494
June, 1951	1,003	969	534	458	570	3,534
Sept., 1951	1,003	975	539	468	592	3,577
Dec., 1951	1,064	1,047	583	492	609	3,795
Mar., 1952	1,017	987	549	481	601	3,634

Number of Coins by Denominations

(Millions)

Average of Quarterly Figures:	2/6	2/-	1/-	6d.	3d.
1945	7.0	8.0	8.4	12.5	30.1
1946	7.5	8.7	9.0	13.5	33.5
1947	7.6	9.0	9.4	14.4	36.5
1948	7.8	9.1	9.6	15.1	38.4
1949	7.8	9.3	9.8	15.9	39.3
1950	7.9	9.6	10.3	17.3	42.2
1951	8.2	9.9	10.9	18.7	46.5
Quarter Ended					
Mar., 1951	8.0	9.6	10.7	18.0	44.2
June, 1951	8.0	9.7	10.7	18.3	45.6
Sept., 1951	8.0	9.8	10.8	18.7	47.4
Dec., 1951	8.5	10.5	11.7	19.7	48.7
Mar., 1952	8.1	9.9	11.0	19.2	48.1

* Excludes an issue of crowns not in active circulation. † Includes Cupro-Nickel Coin.

(£N.Z. thousands)

III—TRADING BANKS
Liabilities and Assets

Average of Monthly Figures:	LIABILITIES (in New Zealand)				ASSETS					Unexercised Overdraft Authorities
	Demand	Time		Total Demand and Time Liabilities	Bankers' Cash*	Net O'seas Assets	Securities		Advances and Discounts	
		Wool Retention Accounts ‡	Other				Govt.	Other		
1945	99,836	—	31,634	131,470	52,402	13,647	29,335	2,473	51,618	40,274
1946	117,071	—	34,414	151,485	67,794	12,541	26,168	2,293	58,342	45,041
1947	128,115	—	37,870	165,984	66,041	13,295	20,913	2,124	76,247	46,669
1948✱	138,211	—	40,403	178,614	68,814	13,464	16,953	1,942	86,470	50,650
1949	150,699	—	39,016	189,715	86,120	14,526	12,856	1,813	81,981	57,686
1950	167,526	—	39,787	207,313	86,674	17,362	11,730	1,677	94,065	64,178
1951	196,663	19,589	39,815	256,068	83,278	27,276	11,716	1,527	133,079	72,230
Last Wednesday in Month:										
1951—Apr.	202,906	13,485	40,074	256,466	77,953	30,000	11,715	1,545	135,921	73,703
May	210,769	16,441	40,302	267,512	87,423	34,018	11,715	1,531	137,636	75,732
June	211,864	18,039	39,449	269,353	86,492	39,492	11,715	1,529	132,743	76,425
July	205,822	21,356	38,659	265,837	87,506	40,059	11,715	1,517	121,428	78,433
Aug.	187,780	25,934	39,199	252,913	93,920	23,712	11,715	1,502	127,001	73,216
Sept.	194,575	29,962	39,781	264,317	97,276	18,802	11,715	1,499	133,030	70,061
Oct.	188,055	30,736	41,093	259,884	91,572	14,108	11,715	1,495	143,227	67,347
Nov.	186,477	31,726	40,364	258,567	85,554	13,401	11,715	1,485	147,336	68,482
Dec.	190,265	32,088	40,125	262,478	70,941	15,680	11,715	1,483	154,456	65,282
1952—Jan.	195,143	31,752	39,398	266,294	77,901	19,868	11,714	1,446	159,266	67,294
Feb.	197,216	30,756	39,382	267,354	68,360	22,694	11,714	1,432	166,164	66,883
Mar.	189,901	30,207	47,730	267,838	38,465	22,101	11,714	1,405	187,259	64,192
Apr.	192,133	29,446	39,091	260,670	46,018	17,796	11,714	1,389	186,623	63,755

* Bankers' Cash includes Notes and Coin, and Balances at Reserve Bank. ‡ See text page 19 of February, 1951, issue.
✱ On and after 20th August, 1948, overseas assets and liabilities converted to N.Z. currency at rate, £Stg.100 = £N.Z.100; previously £Stg.100 = £N.Z.124

IV—FOREIGN EXCHANGE
1. Net Overseas Assets (Revised Series)*

(£N.Z. thousands)

Last Wednesday in Month:	1949	1950			1951			1952		
	Total	Reserve Bank	Trading Banks	Total	Reserve Bank	Trading Banks	Total	Reserve Bank	Trading Banks	Total
Jan.	**64,809**	46,862	16,498	**63,360**	58,413	32,482	**90,895**	58,490	19,868	**78,359**
Feb.	**69,865**	49,179	18,125	**67,304**	65,198	34,053	**99,251**	56,670	22,694	**79,364**
Mar.	**74,975**	54,076	20,100	**74,175**	68,254	31,504	**99,758**	56,662	22,101	**78,764**
Apr.	**77,728**	58,362	23,924	**82,285**	72,410	30,000	**102,410**	57,035	17,796	**74,831**
May	**82,250**	65,607	23,634	**89,241**	80,410	34,018	**114,428**			
June	**79,987**	68,411	18,605	**87,016**	83,824	39,492	**123,316**			
July	**78,037**	67,340	16,169	**83,509**	83,454	40,059	**123,513**			
Aug.	**71,747**	66,099	12,302	**78,402**	94,150	23,712	**117,862**			
Sept.	**65,998**	57,635	13,374	**71,009**	91,914	18,802	**110,716**			
Oct.	**62,165**	54,916	13,927	**68,843**	83,855	14,108	**97,963**			
Nov.	**60,102**	53,871	9,670	**63,541**	72,947	13,401	**86,347**			
Dec.	**59,738†**	50,971†	22,013†	**72,984†**	66,123†	15,680†	**81,803†**			

* Foreign exchange and overseas investments held by the New Zealand banking system in respect of New Zealand business, less overseas liabilities. The Reserve Bank figures include not only sterling exchange as formerly, but also other foreign exchange holdings and overseas investments. † Last Wednesday before Christmas.

2. Foreign Exchange Transactions of New Zealand Banking System

(£N.Z. thousands)

Calendar Month	1951					1952				
	RECEIPTS		PAYMENTS		Balance of Transactions	RECEIPTS		PAYMENTS		Balance of Transactions
	Exports	Other	Imports*	Other		Exports	Other	Imports*	Other	
Jan.	30,042	2,125	13,938	3,027	+15,202	20,368	2,272	27,296	2,071	— 6,728
Feb.	26,044	1,509	16,207	2,813	+ 8,532	24,674	4,589	25,276	2,949	+ 1,038
Mar.	15,546	2,188	14,773	2,485	+ 476	24,381	2,564	24,777	4,700	— 2,531
April	18,810	1,544	13,428	2,973	+ 3,953	18,967	3,208	20,704	3,434	— 1,963
May	23,626	1,484	12,765	2,357	+ 9,988					
June	26,862	1,995	12,976	3,220	+12,660					
July	21,429	2,007	15,498	7,067	+ 871					
Aug.	17,083	2,135	21,287	3,425	— 5,494					
Sept.	15,322	1,771	21,842	2,524	— 7,273					
Oct.	19,707	2,025	26,959	3,479	— 8,706					
Nov.	18,189	995	26,853	2,898	—10,569					
Dec.	21,188	2,510	23,629	3,653	— 3,584					
Total	**253,847**	**22,287**	**220,153**	**39,923**	**+16,057**					

* Includes estimated payments for Government imports.

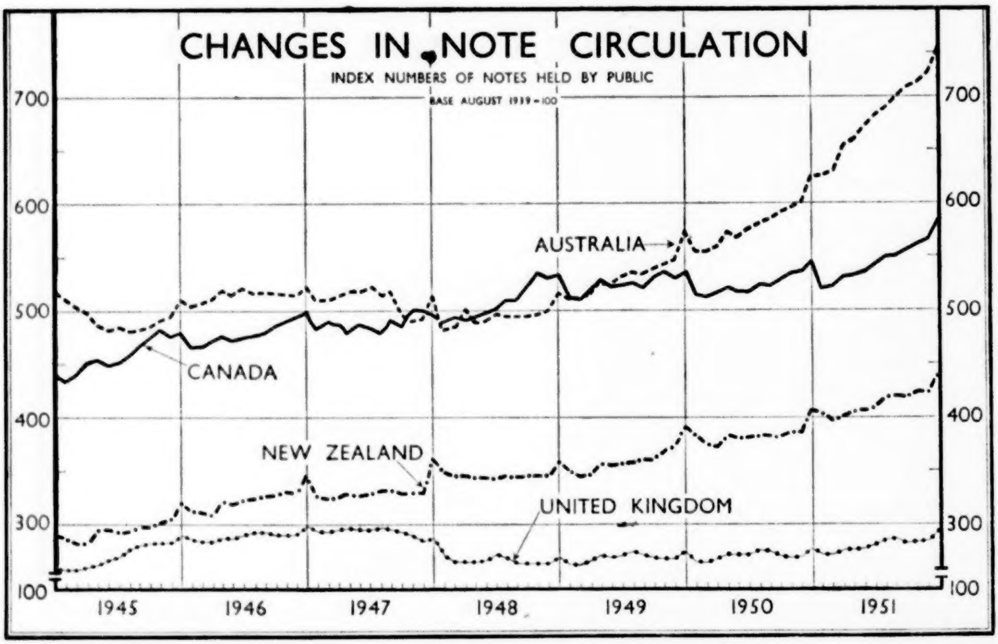
V—CHANGES IN NOTE CIRCULATION

Index Numbers of Notes Held by the Public

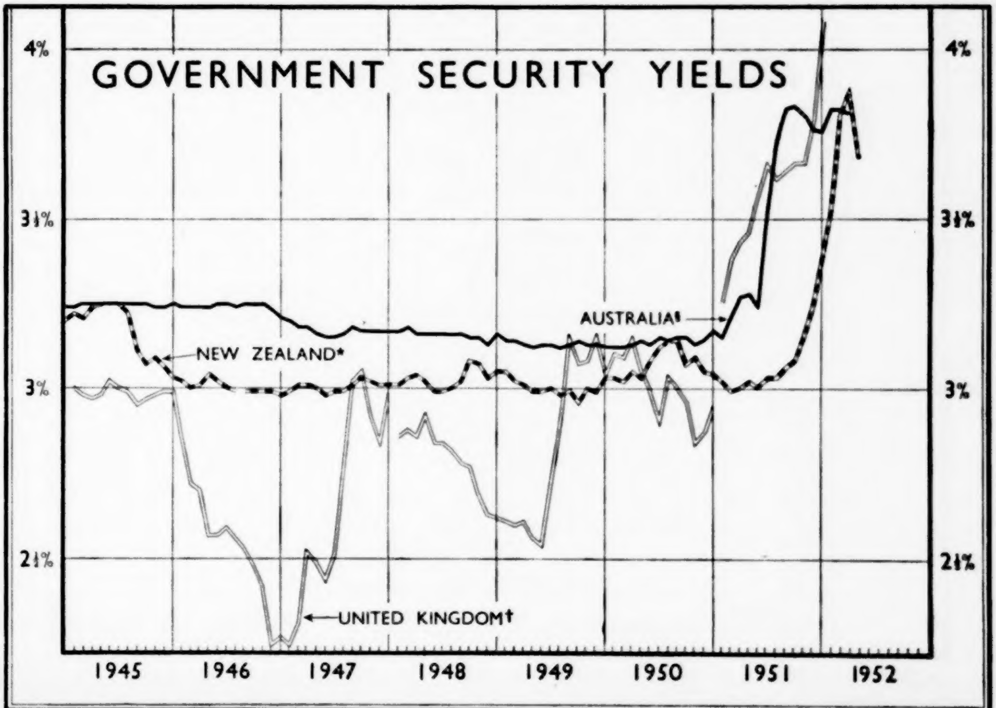
Base: August, 1939=100.

Monthly:	1949				1950				1951			
	United Kingdom*	Canada†	Australia	New Zealand	United Kingdom*	Canada†	Australia	New Zealand	United Kingdom*	Canada†	Australia	New Zealand
Jan.	263	513	511	350	265	514	556	382	271	521	626	403
Feb.	262	510	511	344	264	512	555	375	271	523	630	397
Mar.	266	519	517	346	267	517	560	372	275	533	655	401
Apr.	271	529	527	357	271	521	573	382	276	534	660	406
May	269	523	525	355	271	517	569	380	278	536	671	407
June	271	524	532	356	271	517	577	380	281	543	682	409
July	274	526	536	357	275	524	581	382	285	550	690	419
Aug.	271	522	535	360	274	523	585	382	286	551	699	420
Sept.	268	531	539	360	270	529	591	381	282	557	709	419
Oct.	267	537	543	369	268	535	595	385	283	562	713	423
Nov.	267	531	547	372	269	537	601	385	284	567	722	423
Dec.	273	536	571	392	277	546	625	406	293	581	742	440

* Notes and coin excluding notes and coin held by Bank of England Reserve, London Clearing Banks and Scottish and N. Ireland Banks.
† Chartered Bank note circulation and Bank of Canada notes—average of daily figures.



Calendar Year	In New Zealand	In London			In Australia
	Long-term*	N.Z. Government Long-term 3½% 1962-65	British Gov't. Long-term†	British Gov't. Short-term ‡	Commonwealth Long-term§
1946	3.01	2.62	2.55	2.09	3.22
1947	3.00	2.62	2.67	2.18	3.17
1948	3.03	2.88	2.79	2.02	3.14
1949	3.00	3.13	2.83	1.94	3.13
1950	3.07	3.24	2.99	2.03	3.14
1951	3.08	3.52	3.59	1.85	3.53
Monthly:					
1951—May	3.00	3.33	3.55	1.89	3.24
June	3.03	3.46	3.66	1.99	3.51
July	3.03	3.49	3.62	1.89	3.73
Aug.	3.06	3.47	3.64	1.83	3.82
Sept.	3.08	3.52	3.66	1.71	3.83
Oct.	3.15	3.58	3.66	1.70	3.80
Nov.	3.24	3.68	3.78	1.97	3.76
Dec.	3.38	4.04	4.08	2.29	3.75
1952—Jan.	3.52	4.16	4.14	2.36	3.82
Feb.	3.80	4.15			3.82
Mar.	3.87	4.31			3.81
Apr.	3.67	4.15			
May					



* 3½% 1953-57 Stock to July, 1946; 3% 1960-63 Stock from August, 1946.

§ Compiled from "Statistical Bulletin", Commonwealth Bank of Australia. Estimated from rates on securities maturing in 10 or more years.

† Compiled from "Monthly Digest of Statistics" of United Kingdom. 3% Savings Bonds 1955-65 to December, 1944; 3% Savings Bonds 1960-70 to December, 1947; 2½% Savings Bonds 1964-67 to December, 1950; 3% Savings Bonds 1965-75 from January, 1951. (In 1950 the average yield on 3½% War Loan stock was 3.77 and on 2½% Consols, 3.54.)

‡ Compiled from "Monthly Digest of Statistics" of United Kingdom. 2½% National War Bonds 1952-54 to December, 1949; 2½% Exchequer Stock 1955 from January, 1950.

VII—TRADING BANKS' RATES OF EXCHANGE

Quotations current at 2nd May, 1952

(a) NEW ZEALAND ON LONDON*	Trading Banks in New Zealand: BUY		Trading Banks in New Zealand: SELL
	Sterling in the form of Telegraphic Transfers, Bills and Cheques, etc., payable in London and Sterling Notes. At the rate of £Stg.100 0 0 per:—		Sterling in the form of Telegraphic Transfers and Drafts† payable in London and Sterling Notes. At the rate of £Stg.100 0 0 per:—
Telegraphic Transfers (remittances by cable)	£N.Z.100 7 6		£N.Z.101 0 0
	Air Mail‡	Sea Mail	Air Mail and Sea Mail
Bills, Cheques or Drafts payable "on demand"	£N.Z. 99 19 3	£N.Z. 99 10 9	£N.Z.101 0 0
Bills or drafts payable 3 days after presentation	" 99 18 0	" 99 9 6	No quotation
Bills or drafts payable 30 days after presentation	" 99 11 0	" 99 2 6	£N.Z.100 19 3
Bills or drafts payable 60 days after presentation	" 99 4 6	" 98 16 0	£N.Z.100 18 6
Bills or drafts payable 90 days after presentation	" 98 18 0	" 98 9 6	£N.Z.100 17 6
Bills or drafts payable 120 days after presentation	" 98 11 3	" 98 2 9	No quotation
Sterling Notes	£N.Z.97 15 9		£N.Z.101 0 0

(b) LONDON* ON NEW ZEALAND	Trading Banks in London: BUY		Trading Banks in London: SELL
	N.Z. Currency in the form of Telegraphic Transfers, Bills and Cheques, etc., payable in New Zealand and N.Z. Notes. At the rate of £Stg.100 0 0 per:—		N.Z. Currency in the form of Telegraphic Transfers and Drafts† payable in New Zealand and N.Z. Notes. At the rate of £Stg.100 0 0 per:—
Telegraphic Transfers (remittances by cable)	£N.Z.101 0 0		£N.Z.100 7 6
	Air Mail‡	Sea Mail	Air Mail and Sea Mail
Bills, Cheques or Drafts payable "on demand"	£N.Z.101 8 6	£N.Z.101 17 6	£N.Z.100 7 6
Bills or drafts payable 30 days after presentation	" 101 15 3	" 102 4 3	No quotation
Bills or drafts payable 60 days after presentation	" 102 2 0	" 102 11 0	No quotation
Bills or drafts payable 90 days after presentation	" 102 8 9	" 102 17 9	No quotation
Bills or drafts payable 120 days after presentation	" 102 15 6	" 103 4 6	No quotation

(c) NEW ZEALAND ON OTHER COUNTRIES	Trading Banks in New Zealand: BUY			SELL
	Telegraphic Transfers	Cheques and Bills on Demand Sea Mail	Notes and Coin	Telegraphic Transfers Cheques, Bills Notes and Coin, on Demand
Australia (£A. per £N.Z. 100)	£A.124 10 9	£A.124 10 9	£A.126 14 3	£A.124 0 0
South Africa (£N.Z. per £S.A. 100)	£N.Z.99 14 0	£N.Z.99 0 0	£N.Z.97 5 3	£N.Z.101 5 6
India (N.Z. pence per Indian rupee)	17⅞d.	17 53/64 d.	17 33/64 d.	18⅜d.
Pakistan (N.Z. pence per Pakistan rupee)	25¾d.	25 11/16 d.	25 15/64 d.	26 55/64 d.
Canada § (Canadian dollars per £N.Z.)	$Can. 2.7490	$Can. 2.7580 $Can.2.7524 (Air)‡	$Can. 2.8063	$Can. 2.7133
United States of America§ (U.S. dollars per £N.Z.)	$U.S. 2.8039	$U.S.2.8100 $U.S.2.8062 (Air)‡	$U.S. 2.8592	$U.S. 2.7714
France§ (French francs per £N.Z.)	983.84	988.38	1,005.68	956.34
Belgium§ (Belgian francs per £N.Z.)	141.69	142.43	144.92	137.20
Switzerland§ (Swiss francs per £N.Z.)	12.26	12.30	12.52	12.01
Holland§ (Guilders per £N.Z.)	10.64	10.68	10.87	10.38
Sweden§ (Kroner per £N.Z.)	14.58	14.66	14.92	14.24

* These rates apply to all parts of the British Isles. ‡ Customer pays Air Mail postage. † Including mail transfers. § Subject to frequent fluctuations.

VIII—NEW ZEALAND OVERSEAS TRADE

Summary of Exports and Imports

(£N.Z. thousands)

MONTHLY

	EXPORTS §					IMPORTS †				
	1947	1948	1949	1950	1951	1947	1948	1949	1950	1951
Jan.	8,947	11,800	19,370	12,615	21,492	8,347	14,301	6,262	11,012	12,306
Feb.	10,913	19,568	10,317	15,429	32,387	6,922	11,002	9,784	13,753	15,004
Mar.	14,306	13,517	15,665	24,630	12,216	10,143	9,773	9,931	15,847	7,718
Apr.	11,762	13,389	13,809	19,686	17,174	7,882	14,960	7,355	8,866	11,473
May	13,117	17,643	20,525	18,544	25,452	10,111	9,828	10,495	12,619	17,465
June	15,254	15,595	13,075	16,650	22,790	9,513	11,256	9,250	11,651	16,741
July	10,350	12,705	10,382	18,004	24,902	10,959	8,230	9,358	14,201	15,347
Aug.	10,886	8,013*	9,618	9,805	19,944	10,079	8,693*	11,190	14,332	20,337
Sept.	5,841	12,771*	7,265	10,361	15,692	15,390	11,736*	10,222	13,002	17,958
Oct.	8,908	6,842	7,299	9,546	19,447	12,737	8,202	11,344	13,831	28,240
Nov.	10,058	7,318	7,598	8,287	15,717	11,405	10,564	13,210	16,239	24,119
Dec.	9,065	8,660	12,367	20,195	20,919	15,237	9,657	11,312	12,543	19,782
	129,406	147,823	147,290	183,753	248,133	128,725	128,201	119,713	157,896	206,490

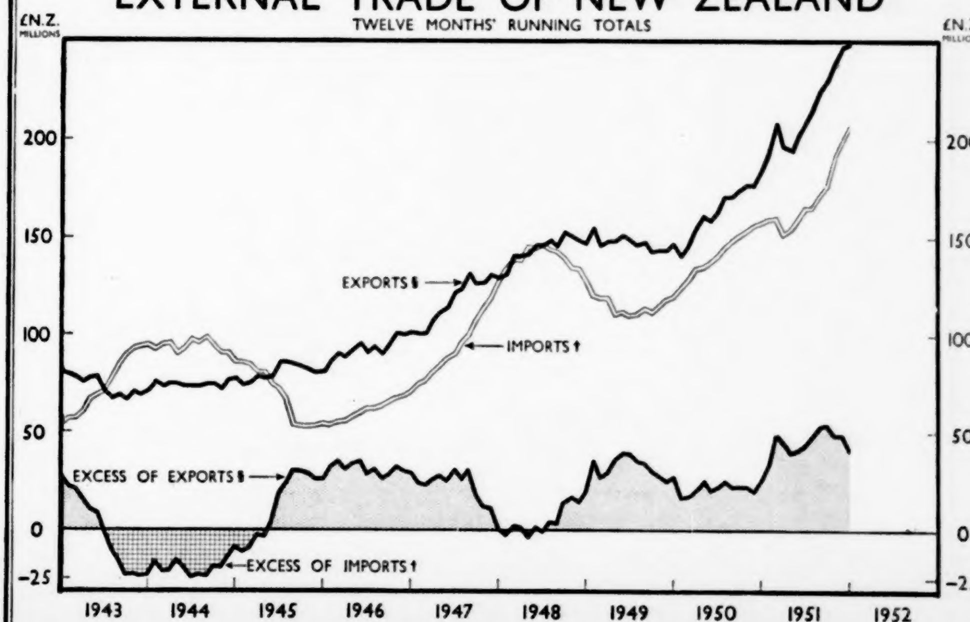
YEARLY

	EXPORTS §					IMPORTS †				
	1947	1948	1949	1950	1951	1947	1948	1949	1950	1951
Jan.	100,225	132,259	155,393	140,535	192,630	75,893	134,679	120,162	124,463	159,190
Feb.	100,899	140,914	146,142	145,647	209,588	77,383	138,759	118,944	128,432	160,441
Mar.	107,438	140,125	148,290	154,612	197,174	81,796	138,389	119,102	134,348	152,312
Apr.	111,992	141,752	148,710	160,489	194,662	84,064	145,467	111,497	135,859	154,919
May	114,361	146,278	151,592	158,508	201,570	88,439	145,184	112,164	137,983	159,765
June	122,082	146,621	149,072	162,083	207,710	91,023	146,927	110,158	140,384	164,855
July	123,747	148,976	146,749	169,705	214,608	96,849	144,198	111,286	145,227	166,001
Aug.	131,566	146,103*	148,354	169,892	224,747	100,241	142,812*	113,783	148,369	172,006
Sept.	126,721	153,033*	142,848	172,988	230,078	108,234	139,158*	112,269	151,149	176,962
Oct.	126,951	150,967	143,305	175,235	239,979	114,835	134,623	115,411	153,636	191,371
Nov.	130,849	148,227	143,585	175,924	247,409	119,549	133,782	118,057	156,665	199,251
Dec.	129,406	147,823	147,290	183,753	248,133	128,725	128,201	119,713	157,896	206,490

† Imports include defence materials and equipment; also lend-lease supplies up to 1946. * August, 1948—figures cover 1st-19th only; September, 1948 figures cover 20th August-30th September (inclusive). § Include small quantities of re-exports.

EXTERNAL TRADE OF NEW ZEALAND

TWELVE MONTHS' RUNNING TOTALS



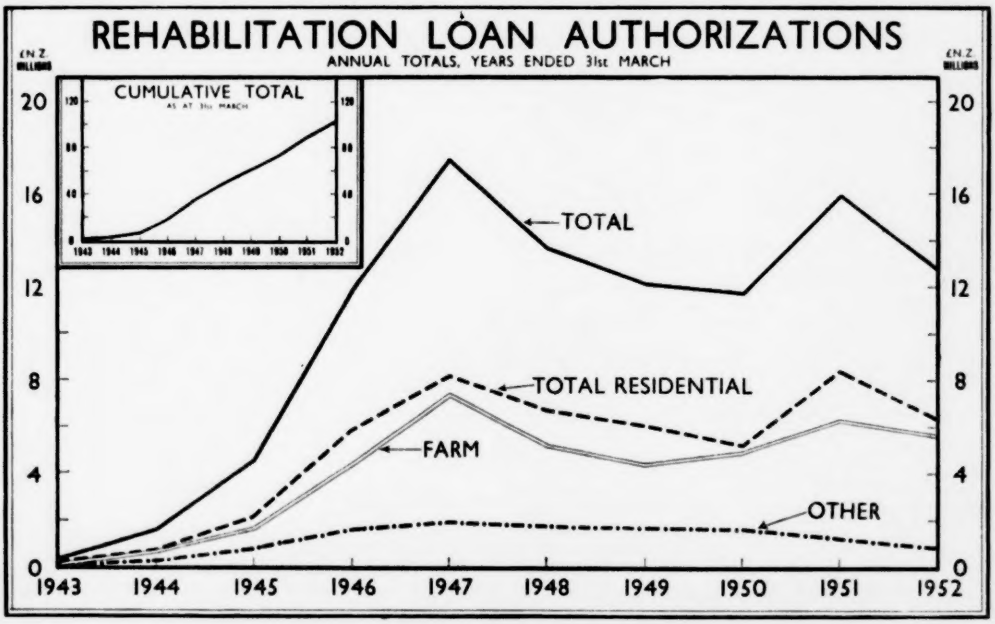
† Include defence materials and equipment; also lend-lease supplies up to 1946. § Include small quantities of re-exports.

IX—REHABILITATION LOAN AUTHORIZATIONS

(£N.Z. thousands) *Source: Rehabilitation Department*

Year Ended 31st March	Residential			Furniture	Business	Farm	Tools of Trade	Miscel-laneous	Totals
	Erection	Purchase	Total Residential						
1943	23	163	186	49	14	128	1	—	377
1944	125	583	708	133	118	634	3	—	1,596
1945	793	1,351	2,144	328	434	1,613	9	8	4,535
1946	2,343	3,519	5,863	620	952	4,323	14	14	11,787
1947	4,031	4,116	8,147	755	1,137	7,342	6	30	17,417
1948	3,818	2,887	6,705	729	997	5,197	5	16	13,649
1949	3,422	2,638	6,061	746	933	4,372	5	8	12,125
1950	2,754	2,447	5,201	678	910	4,889	2	17	11,697
1951	5,589	2,818	8,407	562	631	6,281	1	27	15,909
1952	3,568	2,813	6,381	399	407	5,618	1	4	12,810
Total to 31st March, 1952	27,201*	22,601*	49,802	4,999	6,531	40,398	48	125	101,902
Monthly:									
1951—Mar.	343	223	567	46	39	769	—	—	1,420
Apr.	381	209	590	41	32	635	—	—	1,299
May	497	237	734	49	42	786	—	1.0	1,613
June	309	157	466	38	29	670	—	—	1,204
July	378	252	630	40	32	537	—	—	1,239
Aug.	379	267	646	36	44	287	—	.6	1,014
Sept.	282	231	512	33	20	349	—	.5	915
Oct.	304	248	552	31	41	373	—	.7	998
Nov.	280	269	549	33	40	317	—	—	940
Dec.	204	241	445	21	26	310	—	—	802
1952—Jan.	157	153	310	23	22	296	—	—	651
Feb.	211	269	481	27	34	664	—	—	1,206
Mar.	219	297	515	26	43	394	—	—	979

* Supplementary loans of £735,000 originally included under "Purchase" are now included under "Erection".



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FOREIGN EXCHANGE

A series of articles dealing with:

Foreign Exchange Transactions

Monetary Reserves

The Sterling Area

The Sterling Exchange Standard

Hard and Soft Currencies

Exchange Rates

Exchange Controls

RESERVE BANK OF NEW ZEALAND

CONTENTS

This series of articles on Foreign Exchange was published in the "Bulletin" between February, 1951 and March, 1952. The articles on the European Payments Union were published in the "Statistical Summary" for August and September, 1950. It is now considered desirable that these articles should be reprinted as a pamphlet thereby enabling them to be read in more convenient form and to reach a wider public.

May, 1952. Price 2/6d.

Foreign Exchange

I - EXCHANGE DEALINGS AND RESERVES

The Need for an Exchange Market

EACH COUNTRY HAS ITS OWN MONETARY SYSTEM and its currency is legal tender only within its own territory. The currency of one country does not normally circulate in any other country. Therefore if a person wants to make a payment to someone in another country, it must be made in some form which is acceptable to the payee, i.e., in gold, in bank notes of the payee's currency, or in some document which will enable him to receive payment in his own currency or in some other currency which he is willing to accept. The normal method is for the payer to buy the payee's currency from a dealer (usually a bank) by a procedure to be described later, and to use this to make the desired payment.

In the present world economy the volume of international payments is enormous and each transaction involves the buying and selling of foreign currency, or rather the exchange of one currency for another. Not only is the volume of transactions large, but there are many currencies in the world and there are several methods by which international payments can be made. For the interchange of all the currencies of the world large specialised markets are required, with dealers situated in each country. Exchange rates must be fixed which indicate the ratio at which any one currency can be exchanged for each of the other currencies. Anyone wishing to make a payment in a foreign currency must be able to obtain that currency in the required amount with a minimum of delay, trouble and expense, and the price or exchange rate should preferably be known in advance. Anyone wishing to sell foreign currency should also be able to dispose of it with equal facility and to receive payment in his own currency. Hence the need for specialised dealers in foreign exchange.

Exchange Dealers

Foreign exchange dealers in any country may include some or all of the following:

Central banks, commercial banks, specialised merchant banks; official *ad hoc* institutions such as Exchange Equalisation Accounts or Currency Boards; and private dealers.

Under a system of exchange control the powers of each of the above may be regulated by Government action, and dealings by private individuals other than through official channels may be prohibited altogether.

International Reserves

Just as any merchant must hold stocks of the commodities which he sells, so must a dealer in foreign exchange hold supplies of the currencies most in demand. The holding of currencies less frequently demanded is not so necessary provided the dealer can obtain supplies of these as required or can offer acceptable alternative methods of payment.

The operation of the system of international payments is much simplified by the fact that certain currencies (notably sterling and the dollar) are widely used for the settlement of international transactions and that highly specialised institutions have been established in the main financial centres for the purpose of facilitating exchange dealings. Thus, for example, sterling is accepted as a means of payment between many other countries, and sterling transfers finance trade in goods which never touch the shores of Britain. This arises from the fact that sterling is normally freely convertible into any other currency and that London developed during the 19th century into the predominant exchange market of the world. This predominance has been partly reduced by the development of financial centres in other countries including New York, Paris, and Zurich; and since 1939 the convertibility of sterling has been limited by restrictions made necessary by the war and by the dollar shortage. These restrictions are intended to be temporary and have already been considerably relaxed, so that sterling is once more coming into its own as an international currency.

The facilities offered by the London exchange market are of great value to New Zealand, since New Zealand exchange dealers (the five trading banks and the Reserve Bank) do not need to hold supplies of all foreign currencies but only a few of them, with sterling itself by far the most important. Payments to countries, the currency of which is not held by our banks, or is held by them in small quantities, can be financed by means of transfers of sterling to the payees or by purchases of their currencies in London for sterling.

Generally speaking, foreign exchange dealers, in order to be able to carry out their functions, hold "stock-in-trade" in the form of gold, of major international currencies such as sterling and dollars (this is normally the most important part of the total) and smaller quantities of the currencies of other countries with which they have commercial dealings. The total amount of these international reserves, as they are sometimes called, and the distribution of them among the various currencies, will depend on many factors including the size of the country concerned, the relative importance of its various trading partners, and the state of its balance of international payments. For example, in most countries gold is held by the central bank, and also dollars which at present are in effect as good as gold. To many countries, and particularly to those in the sterling area, sterling balances are a major part of the international reserves.

Purpose of International Reserves

As indicated above, foreign exchange reserves are held primarily for the purpose of financing international transactions. In part they may be looked upon as working balances required to finance day-to-day transactions and to meet short-term changes in the balance of payments. In part they are reserves in the true sense, held to meet possible adverse developments in the future. For if exchange dealers sell more foreign currency than they are buying, they must have

reserves to fall back on, otherwise the available supplies of foreign exchange must be rationed (by means of exchange and import controls), or the price of foreign currencies must be raised (by devaluation of the local currency). Thus an adequate level of international reserves is an essential part of sound monetary management, and a prerequisite of confidence in a currency. Inadequacy of reserves results in a loss of confidence, with the possibility of a flight of capital and of speculation which further reduce the reserves.

Gold has served a dual function. In the days when bank-notes were convertible into gold, the note-issuing banks had to keep a reserve against their note liabilities. The minimum permissible amount of such gold reserve was usually prescribed by law. Nowadays the convertibility of bank-notes into gold for internal circulation is almost unknown, although laws requiring a minimum gold reserve have not all disappeared. Gold now has only one major function in the monetary sphere, and that is as a residual means of settling international transactions.

Form of Reserves

Apart from gold, supplemented in one or two countries by silver, international reserves may be held in the following form:

(a) Deposits with other central banks;
(b) Deposits with other foreign banks;
(c) Treasury bills of other countries;
(d) Commercial bills payable in other currencies;
(e) Securities of the Government of other countries;
(f) Bank-notes of other countries.

For any particular country the form in which international reserves are held depends on the law of that country and on local practice. The main requirements are that the funds or securities should be in appropriate currencies, that a sufficient portion should be in the form of cash, and that the remainder should be in either first class short-term bills (which are soon converted into cash) or in Government securities which are readily marketable.

Official Reserves

Not all exchange dealers are official institutions, and the international reserves of official institutions do not necessarily all qualify for inclusion in official reserves for statutory or statistical purposes. For example, until recently dollars held by the Reserve Bank of New Zealand were not counted in the statutory reserve; and the United Kingdom's official reserves do not include anything but gold and dollars, whereas in practice the Exchange Equalization Account may hold other foreign currencies as well.

The practice concerning official reserves varies from country to country, so that generalisation is difficult. However, most emphasis is given to the holdings by the Central Bank or other official institutions. In some countries the international reserves of the commercial banks may be included for statistical purposes. Private holdings of foreign currency can be regarded as secondary reserves since they are often used by their owners to make international payments; but only in emergencies are they brought under the control of the monetary authorities, and their amount is not usually known.

International Reserves of Various Countries

United Kingdom: There is no legal definition nor prescribed minimum level of monetary reserves, but in practice reference is made to the "Gold and Dollar Reserves". These are the total of the gold, U.S. dollars, and Canadian dollars held by the Exchange Equalization Account, which is operated on behalf of the United Kingdom Treasury by the Bank of England.

U.S.A.: The international reserve consists of gold held by the Treasury. Any gold acquired by the Federal Reserve Banks is passed over to the Treasury in exchange for "gold certificates". Each of the twelve Federal Reserve Banks must hold gold certificates to a value of not less than 25 per cent of its deposits and notes in circulation.

Canada: The international monetary reserve of Canada consists of gold and U.S. dollars held mainly by the Foreign Exchange Control Board, but small amounts are also held by the Bank of Canada and by the Government. There is no law prescribing a minimum level of these reserves. That part of the Bank of Canada Act which required the Bank to hold a 25 per cent gold reserve against its notes and deposits was suspended in 1940 when the Foreign Exchange Control Board was established.

Australia: There is no statutory reserve prescribed for the Commonwealth Bank. From 1935 to 1945 the Bank had to hold a reserve in gold or sterling equal to not less than 25 per cent of its note issue, but this limitation was abolished in 1945. Statistics of international reserves are published in several forms, but the main part consists of gold and sterling held by the Commonwealth Bank.

II - MONETARY RESERVES AND THE REGULATION OF CURRENCY IN NEW ZEALAND

Period up to 1914

Before 1914 the main regulations governing banking in New Zealand were contained in the Banking Act, 1908, and in the Acts governing the separate banking institutions. They provided *inter alia*, that (a) bank-notes in circulation had to be fully covered by a reserve of coin, bullion and public securities held in New Zealand, of which reserve coin had to be at least one-third; and (b) "debts, engagements and liabilities" (as for example promissory notes) were not to exceed three times the total of coin, bullion and securities. In practice most of the coin was gold coin. The intention of these provisions was to limit the amount of notes issued and loans made by the banks. Notes were convertible by law into gold, which circulated freely in the form of coin, and which could be exported or imported without restriction. The foreign exchange rates were stable and parity was maintained

with sterling, which was then on the gold standard. New Zealand currency was thus subject to legislation which provided a legal framework within which the gold standard could have operated. For countries on the full gold standard, that standard was expected to serve two broad functions, namely, (a) to control the volume of money, and (b) to preserve stability in the exchange rates. As the quantity of gold held by the monetary authority regulated the money supply, the total amount of money in a country on the gold standard normally rose and fell as gold flowed in and out. Gold was bought and sold by the monetary authorities at a fixed price, and could be freely exported and imported. This enabled stability to be maintained in the exchange rate despite surpluses or deficits in the balance of payments. Hence if a gold standard country had an unfavourable balance of external payments, gold would be exported and the consequent decline in its gold reserves was regarded as a signal to take remedial action designed to restore the balance of payments and maintain stability in exchange rates. Such action usually took the form of higher interest rates and monetary contraction.

Despite the absence of a mint, central bank, discount rate or money market, the legal framework of a gold standard existed in New Zealand up to 1914. Although the banks held large balances in London rather than gold, these balances were convertible into gold since the United Kingdom was on the gold standard.

Period 1914-34

On the outbreak of war in 1914 some of the currency regulations that had provided the legal framework for the gold standard were suspended. Bank-notes became inconvertible legal tender by Proclamation issued under the provisions of the Banking Amendment Act, 1914, which also prohibited the export of gold except with the consent of the Minister of Finance.

Between 1914 and 1920 the Proclamation declaring notes to be legal tender was periodically renewed. Further changes were made in the currency regulations by a number of Finance Acts the most noteworthy being (a) the suspension of the requirement that the note-issue should be covered to the extent of one-third by coin, (b) the removal of the export ban on uncoined gold, and (c) the extension of the definition of public securities, forming part of the banks' reserves, to include securities issued by the United Kingdom, the Australian Commonwealth, and Australian State Governments.

The effect of these changes was to remove the legal framework for a gold standard. Notes were no longer convertible into gold; in fact there was no obligation on the banks to hold any gold at all.

No further changes, other than the gazetting of successive Proclamations maintaining the legal tender status of notes, were made in the currency regulations until the commencement of business by the Reserve Bank of New Zealand on 1st August, 1934. From that date a new system of currency legislation came into effect.

The Sterling Exchange Standard

Although before 1914 there were certain elements of the gold standard in effect in New Zealand, and although between 1914 and 1934 there was a nominal statutory regulation of currency in New Zealand, in practice New Zealand had been operating all the time on a sterling exchange standard. Even before 1914 the gold standard did not operate in New Zealand in the traditional manner. New Zealand may have been *de jure* on the gold standard, but *de facto* it was not. Those regulations relating to a ratio of bank-notes and bank credit to reserves of coin, bullion, and public securities, had little practical effect. For example, in the June quarter of 1914 the notes issued by the trading banks amounted to £1.7 million, but as the coin reserve then totalled £5.3 million the note issue could theoretically have been increased to nearly £16 million. Again in the September quarter of 1928 notes issued amounted to £6.17 million, while reserves of coin, bullion and public securities amounted to at least £12.45 million. Thus in practice the trading banks held reserves much in excess of those required by law, and the note-issue varied (as did also bank deposits and advances) without any apparent relationship to the level of reserves.

The true basis for the regulation of currency in New Zealand lay not in the legislative requirements but in the funds held by the banks overseas, mainly in London. The principal factor determining the level of bank deposits, advances and note-issue was the level of those London funds. This situation arises from the fact that New Zealand has a high level of external trade relative to the national income, and that the greater part of that trade is financed in sterling through London. As a result one of the most important functions of the New Zealand trading banks has been the financing of external trade and the maintenance in London of adequate funds for that purpose.

The relationship between the level of London funds and the banking situation within New Zealand was as follows. Whenever there was an increase in export receipts the effect was to increase the London funds held by the trading banks and to increase the banks' liabilities to their customers in New Zealand or to reduce their advances, or both. Incomes, and probably also the volume of money, would be increased and after a period there would be a consequential expansion in the demand for imports. Thus the favourable balance of payments would in time be turned into a deficit, the level of London funds would be reduced, and within New Zealand either bank deposits would be reduced or their advances would be increased, or both. If the banks were to expand their advances they would thereby stimulate a demand for imports and their London funds would be reduced, perhaps to an unsafe level. On the other hand if London funds were plentiful the banks were in a position to expand their advances without any immediate fear that they would run short of sterling. If however they did tend to run short of sterling they usually made a small adjustment in the exchange rate with sterling or raised the rate of interest on overdrafts and fixed deposits, or exercised a greater degree of caution in their lending policy.

The above briefly describes the sterling exchange standard as it operated in New Zealand up to 1934. Its essential characteristics can be summarised as follows:—

1. The legislation governing the reserves to be held by banks against their note-issues was of little effect.

2. The note-issue was subsidiary to bank deposits, and varied according to the public's cash requirements.
3. The banks maintained in practice, though not by law, the free convertibility of New Zealand currency into sterling, and held funds in London for this purpose. (Up to 1914, of course, the legal requirement of convertibility into gold was equivalent to a requirement of convertibility into sterling.)
4. The banks bought and sold sterling against New Zealand currency at prices which were at or very close to parity, or which if deviating from parity remained stable for considerable periods.
5. The true reserves of the New Zealand monetary system were not only gold but principally the funds held in London.
6. The level of London funds was the principal factor determining monetary policy in New Zealand.

Establishment of Reserve Bank

From 1st August, 1934, the date on which the Reserve Bank opened for business and commenced the issue of notes, the right of the trading banks to issue notes ceased. At the same time the Reserve Bank acquired all the gold held by the trading banks, which was in the form of coin. The Reserve Bank was required by its statute to maintain a reserve amounting to not less than 25 per cent of the total of its notes issued and its other demand liabilities, such reserve to consist of:—

(a) Gold coin and bullion.

(b) Sterling exchange, comprising deposits at the Bank of England, British Treasury Bills with an unexpired currency of not more than three months, and bills of exchange bearing at least two good signatures and with not more than three months' unexpired currency.

(c) Net gold exchange (i.e. central bank balances and bills of exchange payable in gold standard countries).

From the total of those items was to be deducted the liabilities of the Bank in currencies other than New Zealand currency. The Act also provided that the Bank should buy and sell sterling on demand against payment in notes and should fix the rate at which such transactions would take place.

In the provisions of the Reserve Bank Act the sterling exchange standard, which had grown up informally over a period of years, became officially recognised as the basis of New Zealand's monetary system, and the maintenance of convertibility of New Zealand currency into sterling became obligatory on the Reserve Bank. The sterling exchange standard depends on this convertibility, and operates in its truest form only if internal monetary policy is designed to ensure that this can be maintained at all times. If however internal monetary measures or other factors increase the demand for sterling relative to the reserves held by the banks, the free convertibility of New Zealand currency into sterling at a fixed rate cannot be maintained unless corrective measures are taken. Such a situation arose in New Zealand in 1938, and in December of that year the Government introduced a system of exchange and import controls in order to prevent the exhaustion of sterling reserves. Before this could be done it was necessary to suspend the obligation of the Reserve Bank to sell sterling on demand (the Sterling Exchange Suspension Notice, 6th December, 1938). In this way one of the basic features of the sterling exchange standard was removed, and it became possible through the operation of controls over imports and other payments to have a domestic monetary policy not primarily based on the level of London funds. Subject to the exchange and import controls, and to the bulk-purchase contracts covering exports of meat and dairy produce, trade and payments continue to operate very much as before, and London funds continue to be one of the most important factors in our economic system. Yet the sterling exchange standard now operates only in a much modified form.

Statutory Changes in 1950

Changes in the legislation governing the regulation of the currency and monetary reserves were made when the Reserve Bank Amendment Act was passed in August, 1950. The provision requiring a 25 per cent minimum reserve ratio was repealed and replaced by the following—"It shall be the duty of the Bank to maintain reserves which, in the opinion of the Board of Directors, will provide a reasonable margin for contingencies, after taking into account prospective receipts and disbursements of overseas funds, and having regard to the economic position of New Zealand".

A further amendment made balances standing to the credit of the Bank at the central bank of any country, the currency of which is freely convertible into sterling, available for inclusion in the official monetary reserves.

Net Overseas Assets

It has been the custom in the past to speak informally of "London Funds" or "Overseas Funds" when referring to the external assets of the New Zealand banking system. In practice those funds have consisted mainly of sterling, so that the term "London Funds" is approximately correct. To be more precise, however, it is necessary to use the official term "Net Overseas Assets", statistics of which are published regularly and are made up as follows:—

(a) The reserves of the Reserve Bank as defined in its statute, but not including gold.

(b) Other funds held by the Reserve Bank overseas which are not included in the legislative definition of reserves.

(c) Longer-term investments held in London by the Reserve Bank which are not classified as official reserves.

(d) The net overseas assets of the trading banks, i.e. their assets in London and elsewhere minus their time and demand liabilities outside New Zealand. Included in their assets are cash and call money in London, investments, bills receivable and in transit. Their liabilities include bills payable overseas and borrowings in respect of New Zealand business.

III - EXCHANGE RATES AND TRANSACTIONS

Earlier it was mentioned that the need for foreign exchange markets arose from the volume and complexity of international monetary transfers. All money transactions between countries involve at least one exchange of currencies because each country has its own currency which normally circulates only within its boundaries. Gold, of course, is an international currency but in its monetary form of coin or bars it is used mainly by Government authorities and is not freely available to the private trader.

The use of an international currency such as sterling may involve two exchanges of currencies. First the payer's local currency will be exchanged for sterling which is then exchanged for the currency desired by the payee. Changes from one currency to another are performed by exchange dealers (central and commercial banks, specialised firms, etc.) at prices which express each foreign currency in terms of the local currency. These prices are called exchange rates.

Exchange Rates

Dealers in foreign exchange (other than those holding official reserves) do not usually hold more than small working balances of foreign currencies, but arrange their daily purchases and sales so as to keep them approximately in balance. Also, as with any other dealers, they depend on their sales for their profits. They must therefore quote two prices for each currency in which they are prepared to deal. One of these is the amount of local currency they will give in exchange for a particular foreign currency i.e. their buying rate, and the other is the amount of the same foreign currency they will offer in exchange for local currency i.e. their selling rate. For example, dealers may offer to buy U.S. \$2.80$\frac{1}{8}$ for £Stg.1 and to sell U.S. \$2.79$\frac{7}{8}$ for £Stg.1. The difference between these rates of exchange is the dealers expense and profit margin. Buying and selling rates of exchange are expressed in two ways. Either a specified amount of foreign currency is offered for a unit of local currency, or a specified amount of local currency is offered for a unit of foreign currency. An example of the first is the rate of £Stg.1 = \$2.79$\frac{7}{8}$; and of the second, 1 Indian rupee = 1/6d. (both London quotations).

New Zealand Rates of Exchange

The foreign exchange market in New Zealand is operated by the Reserve Bank and the trading banks. The rates at which the Reserve Bank will buy and sell sterling are fixed by the Bank in terms of the Reserve Bank of New Zealand Act (Section 16), and all rates quoted by the trading banks are approved by the Bank under the Finance Emergency Regulations (1940) No. 2.

Under the Act the Reserve Bank has fixed its buying rate at £N.Z.100 = £Stg.100 and its selling rate at £N.Z.101 = £Stg.100. Transactions carried out by the trading banks are at the rate of £N.Z.100. 7. 6d. = £Stg.100 for purchases and £N.Z.101 = £Stg.100 for sales of sterling for immediate delivery, the transfer being arranged by cable. In addition to these "telegraphic transfer" rates, "usance" buying and selling rates are quoted, i.e. rates for transactions where the sterling funds are transferred only after a certain time. For example, the sterling amount of a traveller's cheque issued in the United Kingdom is not available to the New Zealand trading bank which cashes it for between one and two weeks, because the cheque must be sent by air mail to the issuing bank for collection. Similarly, the sterling represented by a bill of exchange drawn at say "60 days after sight" will not become available to the New Zealand bank which cashes it for about ten weeks. Transactions of this kind involve an interest allowance in the rate of exchange, because the bank is paying out in New Zealand in advance of reimbursement overseas. Thus the rate for buying a sterling traveller's cheque is £Stg.100 = £N.Z.100. 0. 9d. compared with £N.Z.100. 7. 6d. for a telegraphic transfer. The difference represents an allowance for interest and extra expenses involved. On the other hand a bank, in its selling rates for sterling, makes an allowance for interest if the sterling is not paid from its London balances for some time after it receives the New Zealand currency equivalent. For example, a bank will sell a telegraphic transfer of £Stg.100 for £N.Z.101, but will sell for £N.Z.100. 18. 6d., a draft for that amount payable in sterling 60 days after presentation. "Usance" selling transactions are however not common in New Zealand.

New Zealand's rates of exchange with currencies other than sterling are calculated by linking the New Zealand buying and selling rates for sterling with the corresponding London market rates for the other currencies. The reason for this method is that the main part of New Zealand's overseas earnings and payments is in sterling. Our trade with most countries is financed in sterling and only comparatively small amounts are received and paid directly in other currencies. New Zealand banks must buy on the London market the difference between their local purchases of foreign currencies and their sales, and consequently their rates of exchange for these currencies are dependent upon London market rates.

Receipts and Payments

The main source of New Zealand's receipts of foreign exchange is, of course, her exports. These are called "visible receipts" and in 1950 accounted for about 90 per cent of the total receipts of £213.6 million. The remainder, called "invisible receipts" are received from a variety of sources, e.g. overseas visitors to New Zealand, immigrants, interest and dividends on overseas investments, disbursements in New Zealand of overseas companies, commissions and royalties earned overseas by New Zealand firms, and personal receipts, such as legacies and gifts.

The bulk of New Zealand's overseas payments are made on account of imports. These are called "visible payments" and normally make up about 80 per cent of the total. Other payments (the "invisible payments") include interest on public debt domiciled overseas, which requires an annual sum of about £2.7 million, other Government expenditure overseas, expenses of people travelling abroad, and remittances of profits, interest and dividends of overseas firms trading in New Zealand.

Exchange Transactions

The ability of foreign exchange dealers to buy and sell foreign currencies depends upon a series of arrangements which they must make with overseas agents. For example, cable codes, authorised specimen signatures, etc. must be distributed by a dealer to all his overseas agents and methods of settlement for the various types of transactions must be arranged. A dealer will normally open many accounts throughout the world. He will also deal with other agents with whom he has no account and channel business done with the latter through his main accounts. New Zealand dealers (the trading banks) maintain accounts with banks in the United States, Canada, France and Switzerland, and many other countries with which New Zealand has trade and financial relations.

Purchases and sales of foreign exchange take place in a variety of ways, the more common methods used in New Zealand being described below.

Overseas Notes and Coin

It is not common for the trading banks to deal in large amounts of overseas notes and coin, but numerous small amounts are bought and sold by persons travelling from and to New Zealand. The buying rate for notes and coin is less favourable to the seller than other rates, because it has to make allowance for the dealer's expenses in packaging, insuring and returning the currency to the country of origin.

Telegraphic Transfers

A telegraphic transfer (T.T.) is the purchase or sale of foreign currency for immediate delivery. A bank will sell £100 from its balances in London for £N.Z.101 (plus cable charges) and cable its London office to make a payment in the United Kingdom. These instructions will be carried out within a short time of the bank receiving payment from the customer in New Zealand. A telegraphic transfer of funds to New Zealand is the converse of this transaction. An overseas remitter pays his own currency, say, U.S. dollars, into any American bank which acts as agent for a New Zealand bank. The American bank credits the amount to the New Zealand bank's account and cables instructions to it. The New Zealand bank converts the amount of U.S. dollars to New Zealand currency at its buying rate for telegraphic transfers and pays out this amount. In effect the New Zealand bank buys the dollars credited to its account in exchange for the equivalent amount of New Zealand currency.

Mail Transfers

An overseas receipt or payment by mail transfer differs from a telegraphic transfer in that dealers use air mails and not cables to forward their instructions. In these cases the "on demand" rates of exchange are used to convert one currency to another. In other respects the two methods are similar.

Bills of Exchange

One of the main methods by which New Zealand banks acquire foreign exchange is from the purchase of "documentary" and "clean" bills of exchange. A documentary bill is a bill of exchange drawn by a New Zealand exporter on an overseas importer, accompanied by a bill of lading and other documents relating to a shipment of goods. A clean bill is one unaccompanied by documents other than perhaps an invoice or statement.

Clean and documentary bills are usually drawn for the invoice value of the shipment and are expressed in overseas currency. For example, a New Zealand exporter to the U.S.A. might draw a dollar bill of exchange on the American importer for the value of the shipment. In certain circumstances a bank will purchase this bill (called a "negotiation") at the appropriate rate of exchange and pay the New Zealand exporter the New Zealand currency equivalent immediately. The bank then forwards the bill of exchange and accompanying documents to one of its agents near the place where the importer resides. The agent presents the bill to the importer, who after making payment receives the documents which entitle him to take delivery of the goods. The American bank credits the New Zealand bank's account with the proceeds of the bill. This "negotiation" results in the receipt of foreign exchange by the New Zealand bank.

Bills of exchange may be drawn "at sight", i.e., they must be paid when presented to the drawee, or "after sight", which means that the bill does not fall due for payment for the period stated on the bill, say, 30, 60 or 90 days after the drawee has sighted and accepted it. "After sight" bills are sometimes called "usance" bills and a dealer buys them at the appropriate "usance" rate of exchange (referred to above).

Bank Draft

This is a written document addressed by one bank to another authorising the latter to pay the amount of the draft to a named person on presentation. It also states how the paying bank is to be reimbursed. Bank drafts drawn in foreign currencies are sold by New Zealand banks and consequently from New Zealand's viewpoint are sales of foreign currency. When paid, foreign currency drafts drawn by New Zealand banks are charged to their overseas accounts.

When selling drafts on their New Zealand agents, overseas banks pay the appropriate amount in their own currency into the New Zealand banks' accounts. When the draft is presented in New Zealand the bank to whom it is addressed cashes it at its buying rate of exchange. For example, an American bank selling a draft for, say, £10 on its New Zealand agent will pay the equivalent amount in dollars into the New Zealand bank's account. The New Zealand bank, in effect, buys the dollars credited to its account when it purchases the draft for New Zealand currency.

Travellers' Cheques

Travellers' cheques drawn in certain foreign currencies are sold by New Zealand banks for the convenience of travellers going overseas, who may cash them at any place where the necessary arrangements have been made. Such places include hotels, ships, airports, etc., in addition to banks. To a dealer the procedure for the sale, purchase, and reimbursement for a foreign currency traveller's cheque is the same as for a bank draft.

Letter of Credit

A letter of credit is an authority issued by a bank authorising the beneficiary to draw money from another bank or another branch of the same bank. A letter of credit may be "clean" or "documentary", the former authorising payments against cheques or drafts, the latter requiring that bills drawn under the credit be accompanied by the documents relating to a shipment of goods.

The usefulness of a bank letter of credit is twofold. Firstly, it enables the beneficiary to obtain money from a bank to whom he or she is unknown. This is of special importance to travellers who can obtain a letter of credit from their own bank and cash cheques under it in overseas banks. Secondly, it enables an exporter to obtain payment from his own bank as soon as the goods are on board the ship. The credit will state what documents have to be produced before the bank will make payment. Thus the exporter does not need to wait for payment until the importer receives the goods. A letter of credit carries the assurance that drawings under it will be paid by the establishing bank provided that all the conditions of the credit are fully complied with.

Many bills of exchange negotiated by New Zealand banks are drawn under documentary letters of credit.

Clearing Transactions

In view of the fact that a large part of New Zealand's overseas receipts and payments with countries other than the United Kingdom are also made in sterling special clearing arrangements are involved in London.

An American importer who wants to buy New Zealand wool will purchase from his own bank a sterling telegraphic transfer in favour of a United Kingdom bank, and then instruct his wool-buyer in New Zealand to draw sterling bills of exchange on that bank. The London office of the New Zealand bank which "negotiates" the bills of exchange will present them to this bank for payment. Thus the New Zealand bank will receive sterling for wool exported to the United States, and the United Kingdom which pays out the sterling will receive dollars. Another type of transaction is where a bank in, say, India, draws a sterling draft on its New Zealand agent. The former will request its London office to pay the amount to the London office of the New Zealand bank. When the draft is cashed in New Zealand, the bank will pay out the New Zealand currency equivalent of the amount it receives in London.

Cover Transactions

Like other holders of foreign exchange, dealers are always faced with the risk of a change in the exchange rate for currencies they have purchased, but not yet sold. For every purchase of foreign exchange, they have paid out at the current rate of exchange, and should this rate alter they will make either a profit or loss on unsold amounts. Dealers, particularly banks, do not aim at making speculative exchange profits, nor do they want to make speculative losses. Therefore they try as far as possible to balance their sales and purchases of foreign currencies each day. They must hold some balances in order to be able to deal but these amounts are closely watched to keep them within certain limits. It is, however, rarely possible for a dealer to balance his sales and purchases each day by carrying out the normal transactions of his clients. These transactions nearly always leave the dealer with an addition to his holdings of one currency ("overbought") and a reduction in his holdings of another ("oversold"). The dealer could, of course, maintain an "overbought" or an "oversold" position since many of the day's operations, e.g., "usance" transactions, will not involve an immediate movement in overseas cash balances. But since this would probably leave the dealer exposed to the risk of overnight change in an exchange rate, he will "cover" his position. If during the day he has purchased more of one currency than he has sold, he will sell the excess; if his day's sales of another currency have exceeded his purchases, he will buy an amount of that currency to make up the deficiency. These covering transactions are carried out firstly with other dealers; and in the last resort with the central authorities, usually the central bank.

The trading banks in New Zealand do not usually carry out cover transactions with each other but use the Reserve Bank and the London market.

Forward Exchange

Importers and exporters are buyers and sellers of foreign currencies and may be exposed to exchange risks. An exporter who has given a firm price in overseas currency for a shipment of goods, will have done so only in the knowledge that the local currency equivalent of the contract price will cover his costs and provide a profit. Similarly an importer will accept a price expressed in overseas currency only when it converts into a local currency price which will enable the goods to be sold at a profit. When an exchange rate changes, importers and exporters may make exchange losses or profits, unless they take steps to avoid them.

Foreign exchange dealers will, provided certain conditions are fulfilled, protect buyers and sellers from exchange risks by contracting to deal with them in the future at rates of exchange fixed in advance. Such transactions are called forward exchange contracts, and their essential feature is that the dealer and client agree on a rate of exchange which will apply to a future transaction or series of transactions, over a stated period, regardless of what the future exchange rate might be. For example a dealer might agree to buy or sell \$100 in a month's time at \$3 = £1, but in the meantime the actual rate may have changed to \$3½ = £1. In practice, dealers quote their forward buying and selling rates in monthly periods up to, say, six months ahead, and allow a margin in them to cover their risk and extra expenses involved by undertaking forward exchange contracts.

New Zealand banks offer forward exchange contracts in the principal currencies in which they deal.

IV - THE FUNCTIONS OF GOLD

Gold has always been a controversial, fascinating subject. To some people the mention of gold is sufficient to bring to mind pictures of frenzied gold rushes, covered wagons, and roaring guns. To others the word suggests the fabulous wealth of Eastern potentates. To others again it has a sinister meaning, associated with the "mysteries" of banking, the intrigues of international "banksters", and the prevalence of booms, slumps, and unemployment. To such people, gold is something to be feared, and any monetary system which appears to be even remotely connected with gold is something to be opposed and rejected.

The history of the monetary use of gold is relatively simple, being based on three attributes of the metal:—

(a) its colour, glitter and softness made it much sought after for purposes of jewellery and adornment;

(b) its high value relative to its weight made it suitable for coinage purposes;

(c) its scarcity, and the slow rate of increase in its supply, made it a relatively stable measure of value.

In short, gold is universally acceptable and has been one of the best known forms of metallic money.

The first and basic monetary function of gold was therefore as coinage for smaller transactions and as bars for larger transactions. The coins and bars were normally of a specified weight of gold of a specified degree of fineness, each country minting its own.

The second stage in the function of gold occurred in the seventeenth and eighteenth centuries when the practice of issuing bank-notes became common. These were originally issued, for the sake of convenience, as a substitute for gold. The notes were certificates of title to gold lodged at a bank, and authorised the note-holder to claim the gold at any time. The notes soon became transferable and thus fulfilled the function of money, passing freely from hand to hand. So long as the holder of the note was satisfied that he could exchange it for gold whenever he wished, he would not bother to do so, unless it were for the purpose of making an international payment, or to satisfy a personal desire to hold some gold. The actual conversions of notes into gold became relatively few, so that it became possible for the banks to issue notes to a value greater than that of the gold they held. It was not only safe for them to do this, but it was also desirable from the community's point of view, since with a growing population and a greater volume of commercial transactions, more money was needed in circulation.

It was soon recognised that the banks should not have unlimited power to issue notes, for an excessive note circulation would not only cause inflation of prices, but the financial stability of the issuing banks would be endangered. Hence the introduction of legislation to ensure that banks always kept an adequate reserve of gold relative to the notes they had issued. In this way it was hoped to prevent undue expansion of the note-issue and to maintain the convertibility of notes into gold. A landmark in the history of banking, not only in the United Kingdom, but also in the world, was the passing of the Bank Act in 1844, which *inter alia* began the concentration of the right of note-issue in the hands of the Bank of England, and set an absolute limit to the amount of notes which the Bank could issue without a full backing of gold.

The main reason for the nineteenth century growth in the use of bank-deposits is to be found in the great expansion in trade and commerce that resulted from industrialisation, and the limitation on the size of the note-issue. Led by England, some European countries and America changed from predominantly rural to predominantly manufacturing and trading economies. And the need for money to finance every-day transactions increased as economies expanded and populations grew.

Bank-notes and deposits proved a convenient, even an essential, means of finance; but gold remained the basis of nearly all currencies. By 1870 most important countries possessed a standard gold coin and maintained convertibility of bank-notes into gold, and from this function of gold developed an international monetary system. This was the gold standard.

The Gold Standard

The gold standard evolved during the nineteenth century was maintained during the early part of the twentieth century because the essential conditions for its operation were present and it successfully met the requirements of international trade. The principal characteristics were as follows:—

1. The monetary unit of a country was declared by law to be equal to so much gold by weight.
2. Monetary authorities (i.e. Central Bank or Treasury) were ready to buy and sell gold on demand at a fixed price and in unlimited quantities.
3. The free import and export of gold was permitted.
4. Official monetary reserves were held in the form of gold coin and bullion.

In countries on the gold standard gold served a double function. Since a country's permissible money supply was directly related to the size of its gold reserves by the convertibility requirement, it hindered the development of inflation; while free convertibility of one currency into another at fixed prices was ensured. A gold standard country could only increase its money supply when gold reserves increased, and apart from increased mining production (available to only a few countries), gold could only be acquired through trade.

Of perhaps greater importance than the legal attributes of the gold standard was the underlying political and economic philosophy, which created the environment in which gold could play its important role. Free trade, free enterprise and unrestricted capital movements provided a framework in which purely monetary action was deemed effective in regulating economic activity.

The basic assumption on which the gold standard was operated was this:—If a country's money supply were unduly expanded, or if for other reasons its production costs were out of line with those of its trading partners, its balance of payments would become adverse (i.e. demand for foreign currency would exceed the supply) and the international deficit

would be financed by payments of gold. Owing to the depletion of its monetary reserves the Central Bank would be compelled to take remedial action, usually by raising its Discount Rate and engaging in Open Market Operations—two monetary devices designed to dampen down economic activity and reduce prices. The demand for imports would be thereby reduced, the sale of exports stimulated, and "visible" trade would be restored to balance. The "invisible" balance of payments would also be improved by the inflow of capital attracted by higher interest rates. In these ways the loss of gold would be corrected and the level of gold reserves restored.

Converse action was taken when a favourable balance of payments produced an expansion of gold reserves. In order to restore equilibrium monetary policy was designed to stimulate economic activity and raise prices. Thus the convertibility of the currency into gold and into other currencies at fixed rates of exchange—two fundamental objectives—were preserved.

There can be no doubt that during the nineteenth century convertibility of currencies and stability of exchange rates contributed much to the growth of international trade. But these two objectives were achieved only at the expense of internal monetary stability, which at that time was regarded by monetary authorities as a subordinate objective. Monetary policy was aimed at maintaining convertibility of currencies and stability of exchange rates, not price stability or full employment. Fortunately the gold standard period was one of rapid economic development and freedom from major wars. Economic fluctuations were by no means unknown, but they were not as severe as more recent ones have been. The gold standard was thus permitted to operate fairly smoothly.

From 1914 onwards the gold standard began to disintegrate. With the outbreak of World War I the convertibility of currencies into gold was suspended in many countries; gold coins were withdrawn from circulation; the free export of gold was suspended; restraints on the note-issue were relaxed; trade was subjected to controls and tariff barriers; exchange rates were often allowed to move freely, or were arbitrarily "pegged" by decree; but what was more important, monetary policy was directed to new purposes. When the war was over, and currency chaos was widespread in Europe, well-meaning attempts were made to restore gold to its former function as the basis for currency systems. For a short period during the 1920's and early 1930's the gold standard was restored in a modified form in several countries, but from 1931 onwards, pressure of circumstances associated with the great depression forced the rapid abandonment of what remained of it. The era of the gold standard finally closed round about 1936.

Countries were unable to maintain the gold standard because they could not, in the face of chronic adverse trade balances, trade restrictions, capital movements, unemployment, and price fluctuations, maintain the free convertibility of their currencies into gold at fixed prices. International finances were too chaotic, too unpredictable; their gold reserves were too low. But what is probably more important, they were increasingly unwilling to subordinate internal monetary policy to the objectives of currency convertibility and fixed exchange rates. Increasing emphasis is now being placed on domestic economic stability and full employment. Governments want to be free to adopt whatever monetary policy they think appropriate, without having to consider all the time the level of their gold reserves. Though some countries still require their Central Banks to maintain a specified minimum reserve of gold against their notes and other demand liabilities, this rule is no longer a major determinant of monetary policy. The convertibility of notes into gold coin has disappeared. Such gold reserves as are maintained are almost completely unrelated to the money supply.

Stability of exchange rates is still generally regarded as a desirable objective, and is one of the aims of the International Monetary Fund; but for this purpose it is no longer necessary to make the Central Bank buy and sell gold on demand at a fixed price, nor to permit the free export and import of gold. Exchange rates can be fixed by law, or by executive decision, without any reference to gold at all; but it is still convenient (as in the Articles of Agreement of the I.M.F.) to use gold as a nominal unit of account for calculating the "par values"—and therefore the exchange rates—of the various currencies.

Convertibility of currencies into each other is also a generally accepted objective, but this can be achieved without using gold as an intermediary. During the last hundred years or more the banking mechanism for making international payments has been brought to a high state of efficiency; gold is not used for individual commercial transactions, but only in certain limited circumstances in final settlement of net balances owing between official monetary institutions. Normally these balances are adjusted merely by the rise and fall of internationally held bank balances, recourse to gold payments being only a residual measure.

Nevertheless gold has by no means entirely lost its function as a universally acceptable means of settling international transactions. Countries still desire to obtain and hold adequate gold reserves; the undesirability of losing gold to other countries still provides an effective incentive for them to try to maintain balance in their international transactions. This fact is recognised in the part which gold plays in the rules and operations of the International Monetary Fund, the International Bank, and the European Payments Union. Members of these organisations are likely to lose part of their gold reserves if they have a persistent deficit in their balance of external payments; and this fact influences their policies in relation to money, trade, and foreign exchange. But the international financial arrangements of the 1950's differ greatly from the gold standard which operated before 1914.

V - THE STERLING AREA

The sterling area today is a monetary area defined by the United Kingdom Government from time to time in terms of its Exchange Control regulations. This statutory recognition is the latest stage in an evolutionary process which has been going on for about a hundred years, during which sterling became

firmly established as a major world currency. The beginnings of the sterling area go back to the time when overseas countries commenced to hold more sterling than they needed to finance current requirements. That is, they started to hold sterling as well as gold as their monetary reserves, because sterling was a safe currency which could be used to settle transactions anywhere in the world. In the nineteenth century Britain was the world's largest trading nation and supplier of capital. London had by then become the financial centre of the world, and many countries found it convenient to link their currencies to sterling. Britain was then on the gold standard, which meant that sterling could always be turned into gold at a known parity.

The Sterling Bloc

The appearance of a more or less definite group of currencies linked with sterling began in 1931 when the United Kingdom suspended the gold standard and allowed sterling to depreciate relative to gold and the dollar. This act forced the many countries which held sterling as their monetary reserves to decide whether they would link their currencies to sterling or to gold. Before 1931 it did not matter much whether gold or sterling was the monetary reserve, because these were freely interchangeable (except for the period between 1914 and 1925). This position was completely changed in 1931. From the confusion in exchange rates which resulted from Britain's action in suspending the gold standard and allowing sterling to depreciate there emerged an area of exchange stability which became known as the "sterling bloc". The first group to continue to tie their currencies to sterling was the British Commonwealth, with the exception of Canada which chose the middle course between sterling and the U.S. dollar. Portugal was the first non-British country to decide to remain with sterling. Countries which formed the "sterling bloc" can be divided into several groups: firstly, those which at once depreciated their currencies along with sterling, (Egypt, India, Iraq, Portugal); secondly, those which held their parity with gold for a time before depreciating their currencies in one step (Estonia (1933), Latvia (1936), Thailand (1932), South Africa (1932)); thirdly, those which left the gold standard soon after sterling did but allowed their currencies to fluctuate for a time before linking directly to sterling (Sweden, Norway, Finland and Denmark, all in 1933); fourthly, those which were on a sterling exchange standard before 1931 (Australia, New Zealand and Argentina). Some of these countries maintained their old parity with sterling, i.e. they depreciated to the same extent as sterling, but others took the opportunity (either in 1931 or later) to peg their currency lower than its former sterling value. For example, New Zealand's rate of exchange with sterling, which was £N.Z.110 = £Stg.100 in 1931, was altered to £N.Z.124 = £Stg.100 in January, 1933.

Many motives impelled countries to join the "sterling bloc". For the British Commonwealth other than Canada the decision to remain linked to sterling was more or less automatic. Part of the Commonwealth had already left the gold standard before 1931 and for the remainder the only decision to be made was the extent to which sterling should be followed. But both within and outside the Commonwealth there were good economic reasons for the choice. The countries concerned had always been in close financial and commercial contact with the United Kingdom. A large part of their foreign trade was conducted with the United Kingdom, most of their external trade was financed in sterling, and many of them had short and long term capital liabilities in London. The traditional political and commercial ties within the Commonwealth were strengthened further by the Ottawa system of imperial preference in 1932, and the United Kingdom's connections with non-British countries were reinforced by a series of bi-lateral trade agreements. Some twenty of these were negotiated between 1931 and 1937. It was a matter of great importance to all these countries firstly to maintain stable exchange rates with their principal trading partner, and secondly to safeguard their competitive position on the British market by allowing their currencies to depreciate in company with sterling. Failure to do so would have meant that their currencies were "over-valued" relative to sterling, and this would have compelled them either to deflate their costs or to lose their competitive position in the British market.

Finally, internal prices in the United Kingdom remained comparatively stable while those in the "gold bloc" countries (i.e. those that did not allow their currencies to appreciate but remained temporarily on the gold standard) fell steadily. Experience after 1931 soon showed that sterling offered some stability which was lacking in other currencies, and by adhering to a sterling standard it was possible to maintain stable exchange rates.

At this stage of its development the characteristics of the "sterling bloc" were clearly recognizable. It was an area in which the countries concerned kept their currencies at a fixed relationship with sterling and held their exchange reserves either wholly or partly in sterling balances or sterling securities. This relationship existed irrespective of whether or not the countries concerned were technically on the gold standard. The events of 1931 were significant because they showed which countries were prepared to follow the United Kingdom in suspending the gold standard and allowing their currencies to depreciate in terms of gold. Having freed themselves from the obligation to convert their currencies into gold at fixed prices, and having allowed their exchange rates to move more or less freely, these countries were no longer under pressure to reduce their price levels and could adopt the principle of a managed paper currency.

Membership of the "sterling bloc" was voluntary and informal. There was no organisation or agreement involved, and no attempt to pursue a common monetary policy nor to confer as a unit on monetary matters. Adherence to the bloc was a matter of convenience and self interest of the participating countries. Members had access to the London market for capital and foreign exchange and although Britain was no longer on the gold standard sterling was convertible into other currencies.

War and Post War Developments

The outbreak of war in 1939 caused several fundamental changes in what now came to be officially called the "sterling area". Firstly, several European countries formally severed their link with sterling. For example, in August, 1939, Sweden, Norway and Finland discontinued the use of sterling as a basis for their foreign exchange quotations and used the United

States dollar instead. Denmark followed suit in September. Secondly, exchange control had to be introduced in the United Kingdom as a war measure and for this purpose the sterling area was recognised as a single unit. Membership of the area was defined by the British Government in July, 1940, when it comprised the British Commonwealth (exclusive of Canada, Newfoundland and Hong Kong) Egypt, the Sudan, Iraq and Iceland. The Faroe Islands were included after 1941. Thus for the first time in its history the sterling area was given a legal basis.

The essential features were as follows:—

(*a*) All transactions within the area, including capital movements, were free from control by the United Kingdom.

(*b*) The United Kingdom rules relating to remittances outside the area were broadly adhered to by the other participating countries. It was reasonable that funds should be freely remittable from London to other members of the area only if those countries co-operated with the United Kingdom's policy in respect of remittances to non-sterling countries. Otherwise there would be a "leakage" of funds from the United Kingdom, whose reserves of gold and dollars would thereby be reduced and the purpose of exchange control frustrated.

(*c*) To meet the specially urgent problem created by the dollar shortage, a "dollar pool" was formed round the nucleus of the gold and dollars held by the Exchange Equalisation Account. Members of the sterling area agreed that any surplus of dollars earned by them would be paid into the pool, and the United Kingdom agreed that they could draw on the pool to finance any dollar deficit, provided of course that they exercised due restraint in dollar expenditure and sought to increase their dollar earnings wherever possible. This general understanding still applies, although special arrangements exist for South Africa and some of the colonial territories.

(*d*) Transactions between the sterling area and other countries were regulated by a series of bi-lateral agreements, which set out *inter alia* the extent to which sterling could be used by those countries for payments to third countries.

(*e*) Subject to the above agreed rules being adhered to, the United Kingdom authorities did not impose any restrictions on the exchange transactions of other members of the sterling area, including transfers of sterling in London to non-residents of the sterling area.

(*f*) There is nothing in the sterling area arrangements to prevent other members of the area from applying such additional exchange and import controls as their own circumstances may require.

Since 1945 the sterling area has been concerned with the problems that have faced sterling as an international currency. These problems, connected mainly with the convertibility of sterling into dollars, have made it necessary for the wartime restrictions on the transferability of sterling to be maintained, with modifications from time to time. The objective has been to allow as much freedom as possible in the use of sterling by non-members of the sterling area, and for one brief period of a few weeks in 1947 convertibility of sterling into dollars was restored.

Changes in membership of the sterling area, (since 1947 officially known as the "Scheduled Territories") occur from time to time. Palestine and Egypt left in 1948 and Jordan became a member in 1950. At present the members are the British Commonwealth (except Canada), British Mandated Territories and Protectorates, and Burma, Eire, Iceland, Iraq, Jordan and Libya.

Advantages and Obligations of Membership

For New Zealand the advantages to be derived from participation in sterling area arrangements are considerable. They include the following:—

(*a*) There are no restrictions on payments from the United Kingdom and most other sterling area countries to New Zealand.

(*b*) We retain full use of the facilities provided in the London exchange market for the multilateral settlement of our exchange transactions.

(*c*) Any deficit in our balance of payments with other countries can be financed by the use of our sterling funds in London. This is particularly important in relation to the dollar area, with which New Zealand has a persistent deficit. If we had been outside the sterling area in the period since 1939 we would have had to earn, through our own trade with North America, every dollar we spent, and that would have meant even more severe restrictions on dollar expenditure.

Membership of the sterling area involves, of course, some corresponding obligations. These are not imposed on us—they are things which we willingly accept. They are:—

1. To base our exchange control procedures and restrictions, in respect of remittances outside the sterling area, on those of the United Kingdom.
2. To contribute to the general pool any surplus we may earn in our transactions with the dollar area.

These obligations, which are in general agreed upon by all members of the sterling area, are not onerous. They represent our contribution to the effective working of a system within which restrictions are at a minimum and which is based on the widest possible use of sterling as an international currency. It is in our own interests to help to keep sterling strong.

VI - THE CONVERTIBILITY OF STERLING

In the first article in this series it was stated that exchange dealers can freely buy and sell foreign currencies only if they hold adequate stocks of those currencies. If adequate stocks are not held, restrictions may have to be applied either to trade or to international payments, or to both. Such restrictions so interfere with the flow of goods and services throughout the world that economic welfare is adversely affected. The free flow of capital funds is also desirable, provided the funds are required for

legitimate investment and are not in the nature of "hot money" moving between countries for speculative purposes. Circumstances may arise, however, when the advantages of free convertibility of currencies must be sacrificed, in an emergency, in order to prevent a breakdown in the mechanism of international payments.

Sterling as an International Currency

For a hundred years or more prior to 1939 sterling was an international currency in the fullest sense. Not only was Britain's own trade very substantial but there was also a large entrepôt trade, British merchants acting as middlemen organising trade between other countries. The goods concerned did not necessarily touch the shores of Britain. All this trade was normally financed in sterling. Moreover other trade in which British merchants did not participate was often financed in terms of sterling. The money market in London thus became specialised in the financing of international trade, and in fact about 50 per cent of world trade was financed in terms of sterling. It was possible for any country to use its sterling funds to meet payments due to any other country, either by transferring the ownership of sterling or by buying the required foreign currency in the London market. It was normally possible also to buy gold in London if desired. During most of the period since 1914 this convertibility of sterling into exportable gold has been suspended, but (war-time emergencies apart) sterling was freely convertible into other currencies and was freely transferable to the ownership of other countries. This absence of restrictions on the use of sterling was facilitated by the fact that Britain was a major producer of manufactured goods for world markets, and because the balance of receipts and payments for the United Kingdom was relatively stable. A net excess of payments for imports over receipts from exports, i.e., an adverse "visible" balance, was met from a net surplus in "invisible" transactions—receipts from shipping, insurance, banking and commercial services, and overseas investments. There was equilibrium also from a regional point of view—surpluses with some countries could be offset against deficits with others without any balance of payments problem arising. In the circumstances described above it was natural that other countries should find it desirable to hold sterling funds.

War-Time Controls

With the introduction of exchange control in the United Kingdom at the outbreak of war on 3rd September, 1939, sterling was no longer freely convertible and freely transferable. Exchange control was introduced as a war measure, its legal basis being the Defence (Finance) Regulations issued originally under the Emergency Powers Defence Acts, but since 1947 under the Exchange Control Act. The change-over from a peace to war economy meant not only a substantial increase in overseas payments due to a higher level of imports, but also a decline in exports, and a loss of earnings from the "invisibles", in particular shipping and overseas investments. Moreover it involved some far-reaching changes in the pattern of the United Kingdom's trade. The reason for the introduction of exchange and quantitative trade controls was therefore the conservation of the gold and non-sterling area currency reserves and income to ensure that they were used to the maximum national benefit.

If controls had not been introduced, foreign exchange urgently needed by the United Kingdom would have been sold to other countries for payment in sterling, and this loss of reserves would have been added to the drain caused by Britain's own requirements of foreign exchange. This applied particularly to dollars and Swiss francs, the currencies which were in shortest supply.

The structure of exchange control which was built up in the United Kingdom was a complex and changing one, so that it is not practicable to describe it in detail here. The main features may, however, be summarised as follows. The sterling area was formally established, payments within that area being left free from control. The gold held by the Bank of England was transferred to the Exchange Equalization Account, which also acquired privately-held gold; privately-held securities and balances in certain specified countries were brought under control and in some cases (mainly dollar securities) were requisitioned by the Government; restrictions were placed on remittances by residents of the United Kingdom to countries outside the sterling area, especially for capital purposes; and restrictions were placed on the extent to which non-residents of the sterling area could use sterling for making payments to other non-sterling countries. The severity of these restrictions on the transferability of sterling varied adversely with the willingness of the recipient country to use the funds to buy sterling area goods or to accumulate sterling.

In the administration of exchange control in the early stages two types of sterling accounts were established—"registered accounts" and "special accounts". The former related to the sterling which accrued to the accounts of United States and also of Swiss banks, and later of approved corporations in those countries; such sterling balances were convertible into dollars at the official selling rate, and were thus in effect freely convertible into any currency. The "special accounts" related to the various countries with which bi-lateral agreements had been signed. Sterling in such an account could be used only for transactions between that particular country and the sterling area, unless special exceptions were stated in the agreement or were permitted by United Kingdom exchange control in individual cases. In May, 1941, bi-lateral agreements were signed with twelve Central American countries, which were treated as a single unit and their sterling accounts designated "Central American Accounts", each country in the group being permitted to spend its sterling earnings either in the sterling area or in any other Central American Account country. Another main feature of these early bi-lateral agreements was that in some cases, for instance Portugal, Persia and Argentina, gold guarantees were given in respect of the sterling that accumulated in the "special accounts". This meant that the country holding the sterling was guaranteed against any reduction in the gold value of its holdings should sterling be subsequently devalued in terms of gold.

The system of controls and sterling accounts which has been outlined above remained in effect (with some minor adjustments) throughout the war years. The effect was to curtail very substantially the free use of sterling as an international currency.

Post-War Developments

When the war ended in 1945, an immediate return to free convertibility and transferability of sterling was not practicable because of the very serious condition of the United Kingdom's balance of payments, both in total and in relation to the dollar area. Lend-lease, which had made it possible for the United Kingdom to obtain essential supplies from the United States without cash payment, ended in August, 1945. The United Kingdom had suffered severe capital losses as a result of the war, including shipping, buildings, machinery and equipment, overseas investments, and gold and dollar reserves. Moreover she was heavily in debt to other countries both inside and outside the sterling area, because of the very large sterling balances which those countries had accumulated during the war. Finally her dependence upon dollar sources for essential supplies continued and exports to non-dollar countries yielded foreign exchange that could not be converted into dollars.

The Dollar Loans

In the light of the above difficulties it was obvious that, if the British people were not to be subjected to very severe restrictions and a lowered standard of living for an indefinite period, some sort of assistance from the dollar area was essential. If such assistance were forthcoming on a sufficient scale, not only would an almost intolerable degree of austerity be avoided, but also some progress would be made towards the removal of discriminatory trade and exchange controls and the restoration of the free convertibility of sterling. Accordingly the United Kingdom obtained loans of $3,750 million from the United States Government (December, 1945) and $1,250 million from Canada and accepted an obligation to make sterling freely convertible for current (i.e., non-capital) transactions by 15th July, 1947, one year after the loan agreement with U.S.A. came into effect.

Even before the loans were received the United Kingdom concluded financial agreements with many of the liberated European countries in addition to re-negotiating existing bi-lateral agreements. In these negotiations two broad considerations were kept in view. The first was that the new agreements, because of peacetime conditions, would have to finance a greatly increased trade between the sterling area and each of the countries concerned. The second was that the agreements would have to take some account of the need to make sterling freely convertible, and to restore its function as an international currency.

The bi-lateral agreements signed in 1945, though by no means identical in terms, were of a fairly uniform pattern and to some extent followed the model of the war-time "special accounts". They were all strictly bi-lateral in character and contained the following main features:—

1. Trade and financial payments between the country concerned and the sterling area were to be settled in sterling.
2. Such payments were to be channelled through certain accounts held at the respective central banks or at prescribed commercial banks.
3. The use which could be made of balances accruing in these accounts was specified in the agreement, or was left, in part, subject to special agreement between the contracting governments.
4. Provision was made concerning the exchange rates to be used.

Several of these post-war agreements differed from their predecessors in that a "gold clause" was incorporated, which provided that if the country in question accumulated sterling in excess of some specified amount the United Kingdom would freely convert such excess into gold or United States dollars (this provision operated reciprocally). In view of the need to avoid gold losses through the operation of this "gold clause" it became a matter of policy to maintain as close a balance of payments as possible with each of the countries concerned, and to prevent the accumulation by them of sterling balances which might have to be converted into gold or dollars.

The bi-lateral agreements negotiated by the United Kingdom in 1945 and 1946 did little to change the system of "special accounts" referred to earlier or to widen the range of uses to which sterling balances could be put. However, a change had been made in July, 1945, when the "Central American Accounts" were grouped with the United States "registered accounts" into a single group known as "American Accounts". Sterling in such accounts could be freely converted into dollars or transferred to any other country.

Transferable Accounts

During the early part of 1947 a new system of "transferable accounts" was developed in the United Kingdom, with a view to enabling a wider use of sterling as an international currency and to prepare the way for the restoration of full convertibility of sterling. A number of these accounts were established as a result of a new series of bi-lateral agreements. They were similar to the "special accounts" in that all non-capital transactions between the country concerned and the sterling area were channelled through them, but differed in that sterling in such accounts could be used not only for payments to the sterling area, but also for payments to other "transferable account" countries. (In addition, some degree of "administrative transferability" was permitted, i.e. transfers of sterling specifically approved by the United Kingdom exchange control.) More important, however, was the provision that sterling in transferable accounts could be freely transferred to any "American Account" for current transactions. Sterling in the latter accounts being freely convertible into dollars, the requirement contained in the U.K.-U.S.A. Loan Agreement of December, 1945 (that sterling should be freely convertible for current transactions by 15th July, 1947) was thus carried out in respect of the transferable account and American Account countries. In the middle of 1947 the transferable account countries were:—Argentina, Brazil, Uruguay, Belgium, Holland, Portugal, Spain, Norway, Finland,

Italy, Czechoslovakia, Egypt and the Sudan, Iran, Ethiopia, Sweden, Canada, and Newfoundland.

There were still many countries not included in the sterling area, the dollar area, or the transferable account area. For various reasons these countries were still on a strictly bi-lateral basis with the United Kingdom—i.e. their sterling balances could be freely used only for payments to the sterling area, though some "administrative transferability" was allowed. However, in the middle of 1947 it appeared that considerable progress had been made in the restoration of sterling to its normal position as an international currency.

The various measures designed to make sterling once more a "convertible" currency had been largely implemented before 15th July, 1947, the deadline adopted in the Anglo-American Loan Agreement of December, 1945. At the time it was realised that the task of keeping sterling a convertible currency would not be an easy one. Nevertheless there was agreement in the United Kingdom that restoration of the convertibility of sterling would do much to revitalise international trade and there was confidence that any resultant strain on the United Kingdom's gold and dollar reserves could be met.

The experiment proved to be a failure. Some of the countries which had newly regained the right to use the sterling balances to purchase goods from the dollar area made very full use of their opportunities. So rapid was the drain on the United Kingdom's gold and dollar reserves that extensive drawings on the dollar loans were necessary, and on 20th August, 1947, convertibility was abandoned. On that day the countries in the Transferable Account group lost the right to transfer their sterling to American Accounts. That right was the technical device by which convertibility of sterling had been effected; its cancellation therefore effectively limited the free use of the currency and sterling again became technically inconvertible.

During the third quarter of 1947 the net gold and dollar deficit of the sterling area was no less than $1,537 million, and the United Kingdom drew $1,300 million of the United States loan, $150 million from the Canadian loan, and $60 million from the International Monetary Fund. Borrowing on this scale obviously could not continue, as the United States loan was almost exhausted; hence it was necessary to take drastic action in respect both of the use of sterling and of the expenditure of dollars by countries in the sterling area.

By suspending the right of transfer of sterling from Transferable Accounts to American Accounts, the United Kingdom was retracing one step in its progress towards the restoration of sterling to its full status as an international currency. As was emphasised at the time, this action did not mean that the United Kingdom no longer desired to achieve full convertibility of sterling and the abandonment of discriminatory exchange and import controls. It mean merely that the world had not yet sufficiently recovered from the disequilibrium caused by the war to enable trade and payments to flow freely between America and European countries.

After 20th August, 1947, the general pattern of exchange control in the United Kingdom (and therefore, broadly speaking, in the whole sterling area) returned to the *status quo* before 15th July, though there were some changes in detail. Four main groups of countries were distinguished:—

(a) ***The Sterling Area,*** consisting of all the British Commonwealth (except Canada and Newfoundland) plus several countries mainly in the Middle East. The use of sterling for payments within this area was unrestricted as far as the United Kingdom was concerned, although there were local controls in some member countries, including New Zealand. Each country had a wide discretion in converting its sterling into any non-sterling currency, provided its exchange control procedures conformed generally to the policy adopted by the sterling area as a whole.

(b) ***The Dollar Area:*** This included the United States and about twelve of the republics of Central and South America. Such countries were unwilling to hold sterling except as working balances, and therefore enjoyed an unconditional right to convert their sterling into dollars. They were willing to accept sterling in settlement of payments from other countries since in their hands sterling became convertible; but for this very reason the United Kingdom tried to prevent the use of sterling for payments to these countries. Similarly the use of sterling by these countries to make payments to other countries was encouraged by the United Kingdom. If the payments were to a non-sterling country, the latter would not want to receive sterling but would prefer payment in dollars; if to a sterling area country, it did not matter whether payment were in sterling or in dollars, since the payment of sterling out of an American Account reduced Britain's dollar liability.

(c) ***Transferable Account Countries:*** In July, 1947, the countries concerned were Argentina, Brazil, Uruguay, Belgium, Holland, Portugal, Spain, Norway, Finland, Italy, Czechoslovakia, Egypt and the Sudan, Iran, Ethiopia, Sweden, Canada and Newfoundland. They undertook to accept sterling for payments due from the sterling area and from other countries in the group, and in turn were allowed to use sterling to make payments in the opposite direction. After 20th August, 1947, when Transferable Account countries lost their right to transfer their sterling freely some members of this group were at a relative disadvantage in financing their overall trade transactions. Canada, for example, was no longer willing to accumulate sterling balances indefinitely and therefore withdrew from the Transferable Account group. Thereafter Canadian Accounts became equivalent in effect to American Accounts and were freely convertible into Canadian dollars. For similar reasons Belgium and Portugal also withdrew from the Transferable Account system.

(d) ***"Bilateral" Countries:*** With most of the countries not included in either of the three distinct groups defined above the United Kingdom entered into

bilateral arrangements governing the use which such countries might make of their sterling. It was to be freely used for payments to or from the sterling area but other transfers of sterling were subject to administrative control by the United Kingdom authorities.

With several countries in the bilateral group, and with others in the Transferable Account group, the United Kingdom had arrangements which involved the use of gold to settle balances due in certain circumstances. For example, Sweden agreed to accumulate sterling up to £5 million (in addition to some special sterling funds held by Sweden in another account), but if her sterling holdings exceeded that level the United Kingdom undertook to pay gold to Sweden to extinguish the excess, if Sweden so desired. Conversely, if the balance of payments moved the other way and the United Kingdom accumulated Swedish kroner beyond the equivalent of £5 million, Sweden would agree to a gold payment to extinguish the excess. Thus it was in the interests of both countries to ensure that the balance of payments in sterling to or from Sweden was not far out of balance either way. This was achieved by means of appropriate exchange and import controls. Arrangements of this kind were effective, during various periods up to 1950, between the United Kingdom on the one hand and several Western European countries and Japan on the other. In addition, there were special arrangements with Western Germany, Iran, and Curacao which involved for the United Kingdom a potential liability to make settlements in dollars.

It is now possible to attempt a definition of the term "hard currency". No official definition exists, but in common usage a hard currency, from the point of view of the sterling area, is the currency of a country to which gold or dollars may have to be paid in settlement of an adverse balance of payments. The obligation to pay gold or dollars may be immediate (as in the case of the United States) or only potential (as in the case of countries whose sterling balances are well below the level at which the "gold clause" operates). Towards the end of 1947 when the number of hard currencies was probably at a maximum, the list included:

- The United States and dependencies;
- American Account countries (the majority of Latin-American republics, and the Philippines);
- Canada, Sweden, Switzerland, Belgium, Netherlands, Portugal, Spain, Japan (SCAP), Western Germany, Iran and Curacao.

It should be noted that this list has changed from time to time as balance of payments situations changed and new financial agreements were entered into. Moreover there are degrees of hardness, for though the United Kingdom may have a potential liability to pay gold to a foreign country there may be no immediate prospect of such payments being necessary and transfers of sterling to that country can be treated therefore rather more leniently. It should be mentioned also that the above list of hard currencies relates to the exchange control system of the sterling area. For other countries the list of currencies to be treated as hard might differ. For example, the U.S. dollar was soft in Switzerland, while there have been periods when some European countries have been so short of sterling that they have had to impose restrictions on the use of their sterling balances. To them sterling has been a hard currency, even though it has been soft relative to the dollar.

Faced with a serious depletion of its gold and dollar reserves and the almost complete exhaustion of its dollar loans, the United Kingdom nevertheless continued its efforts to solve the problem of its balance of payments and to restore sterling to its full stature as an international currency. The policy adopted after August, 1947, was to try to eliminate the deficits in the sterling area's balance of payments with the hard currency countries, to reduce their holdings of sterling, to remove the "gold clause" from bilateral payments agreements and to increase the number of countries in the Transferable Account group. It was a long and difficult process, since the effect of the war on the sterling area's balance of payments with the hard currency countries was serious, and the many countries which held large sterling balances did not find the sterling area the most advantageous place to buy goods, partly because of high prices and partly because of supply difficulties. Nevertheless, progress was made. The balance of payments between the sterling area and several of the former hard currency countries of Europe improved so much that the arrangement to pay gold when accumulated balances exceeded an agreed level became unnecessary and was dropped by mutual consent; Chile and Peru were persuaded to leave the American Account group, the former joining the Transferable Account group and the latter entering into a bilateral arrangement with the sterling area; and finally the establishment of the European Payments Union in 1950 had the effect of eliminating Switzerland, Belgium and Western Germany from the list of hard currencies. At the present time, therefore, the only hard currencies of any importance in sterling area trade are those of North and South America, and the balance of payments of the sterling area with these countries improved so much in the past two years that a slight relaxation became possible in the severity of restrictions applied to payments to them.

In general, therefore, it can be said that sterling is now a stronger currency and more widely used for international transactions than at any time since exchange control was applied rigorously in 1940, with the brief exception of July-August, 1947. Although free convertibility and transferability of sterling, such as existed before 1939, has not yet been restored, sterling is still a most important international currency. It is not only extensively used by the majority of countries to finance a considerable proportion of world trade, but is also willingly accepted and held with confidence by many countries as their international currency reserves.

The diagram on page 16 is based on an original designed in the Overseas Branch of the Midland Bank in September, 1947. Its purpose is to show in broad outline the main groups of sterling, the channels along which it is permitted to flow and the degree of freedom permitted within the various groups themselves.

UNITED KINGDOM EXCHANGE CONTROL REGULATIONS
OUTLINE OF PERMISSIBLE TRANSFERS‡

———> The arrow indicates direction of transfers, permitted without the necessity of individual approval by the U.K. Control, between different categories of sterling accounts. All other transfers require separate approval.

AMERICAN ACCOUNT COUNTRIES

†Inter-transfers permitted

Bolivia
Colombia
Costa Rica
Cuba
Dominican Republic
Ecuador
Guatemala
Haiti
Honduras
Mexico
Nicaragua
Panama
Philippine Islands
Salvador
U.S.A. and its Dependencies
Venezuela

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TRANSFERABLE ACCOUNT COUNTRIES

Inter-transfers permitted, provided payment is made from an account designated as a "Transferable Account".

Anglo-Egyptian Sudan
*Austria
Chile
Czechoslovakia
*Denmark (including Faroe Islands and Greenland)
Egypt and former territory of Palestine administered by Egypt at present
Ethiopia
Finland
*Greece
*Italy
*Netherlands Monetary Area
*Norway
Poland
Spanish Monetary Area
*Sweden
Thailand
U.S.S.R.
*Western Germany (includes U.S., British and French sectors of Berlin)

"OTHER COUNTRIES"

†Inter-transfers permitted.

Afghanistan, Albania, Eritrea, Liberia, Nepal, Saudi Arabia, Southern Korea.

*SCHEDULED TERRITORIES ("Sterling Area")

Broadly speaking, inter-transfers are freely permitted; but some limitations are imposed by local controls, e.g. South Africa, Fiji, Hongkong, India, Australia and New Zealand

British Commonwealth except Canada
Irish Republic
British Trust Territories
British Protectorates and Protected States
Burma
Iceland
Iraq
Jordan
Libya (comprises Cyrenaica, Tripolitania and Fezzan)

"BILATERAL" COUNTRIES

Inter-transfers *not* permitted unless specifically authorised by U.K. Control.

Argentina
*Belgian Monetary Area
Brazil
Bulgaria
Canada
China
Formosa
*France and French Monetary Area
French Somali Coast
Germany—Russian Zone
Hungary
Israel
Iran
Japan
Lebanon
Paraguay
Peru
*Portuguese Monetary Area
Roumania
*Switzerland
Syria
Tangier
*Turkey
Uruguay
Vatican City
Yugoslavia

† Permitted between each country in the group. * Countries are members of the European Payments Union.
‡ As at 31st March, 1952.

VII - THE DOLLAR PROBLEM

Probably no single economic topic has been so widely discussed and analysed, or had such a determining influence on economic policies in the post-war years, as has the dollar problem of the European and sterling area countries. The importance of this problem lies chiefly in the fact that many countries are unable to procure essential goods and services without relying on extraordinary measures, such as loans, grants and trade restrictions. This directly affects their living standards and has far-reaching social and political consequences.

Import and exchange restrictions which discriminate against goods and services obtained from dollar sources are familiar features of the post-war overseas trade of most of the non-dollar countries. Not so obvious are the causes, which are rather more complex. The difficulties experienced by many countries in financing and regulating their dollar trade cannot be ascribed to any one factor, although the recent war was undoubtedly one of the major causes of the later difficulties.

The seeds of the post-war dollar problem were sown long before the war, however. Before 1939 disequilibrium existed in the trade between what are now termed "hard" (e.g., the U.S. dollar) and "soft" (e.g., sterling) currency areas in that the dollar area, and the United States in particular, had a favourable balance in trade with the rest of the world. That is to say, the United States sold overseas a greater value of goods and services than it bought. (For example, in the nine year period 1930-39, the United States had an average favourable balance on current account of $231 million annually). But the resultant disequilibrium or gap in the current (i.e., non-capital) balance of payments of the rest of the world with the United States was financed without resorting to trade restrictions and exchange control. Gold was transferred to the United States while capital, mostly on private account, flowed out and these transactions compensated for the gap in the current balance of payments. In the period 1919-1939 inclusive the United States had an excess of exports over imports of $19 billion which was largely balanced by a net "invisible" deficit $4.8 billion, a capital outflow of $2 billion, and gold receipts of $10.8 billion.

Causes of Dollar Problem

There were three main causes of the United States favourable pre-war balance. They may be regarded as the long-term causes of the dollar problem. Briefly they are:–

1. The fact that the United States had become increasingly self-sufficient in resources. For example, the ratio of imports to national income declined from more than 5 per cent in 1909-1929 to little more than 3 per cent in 1939. In 1949 imports from countries belonging to the Organisation for European Economic Co-operation represented only 0.4 per cent of the United States gross national product.
2. The tremendous increases that have taken place in the productivity of the United States compared with European countries. This has been a long-term tendency, and has not only lessened the need of the former country for imports, but has stimulated the demand for United States products.
3. The instability of the United States economy. This is a factor of considerable importance in relation to such commodities as rubber, wool, tin, jute, cocoa, diamonds, tea, mica and manganese, which are major dollar-earners for the non-dollar countries. Sales of these commodities fluctuate according to business activity in the United States. A small "recession" in the United States causes a more than proportionate reduction in the demand for imports, which, while they do not bulk largely in the United States national income, account for a significant portion of the dollar earnings and national incomes of non-dollar countries. For example, between the fourth quarter of 1948 and the third quarter of 1949 a fall of 5 per cent in the United States national product and of 10 per cent in manufacturing caused a 30 per cent fall in imports, thereby accentuating the difficulties of non-dollar countries in their attempts to achieve a balance in their dollar trade.
4. The failure of private investment abroad by the United States to recover fully from the adverse effects of the great depression of the early 1930's.

For the above reasons the dollar problem had been developing over many years, but it did not become either apparent or critical until the outbreak of war in 1939. Belligerent countries, especially the United Kingdom, were faced with not only a tremendous demand for American goods that required cash payments, but also with a loss of dollar earnings from exports and "invisible" transactions such as shipping, insurance and travel. While reserves and earnings of gold and dollars were declining, the demand for dollar goods was increasing at an unprecedented rate. The position of the United Kingdom was made more acute through the wide use of sterling, and various measures had to be immediately adopted to ensure that every available dollar was used to pay for urgently needed goods.

War-time Measures

Although the adoption of exchange control and the suspension of sterling convertibility assisted the United Kingdom in the problem of financing an increased flow of dollar imports, these measures were not sufficient by themselves to prevent a serious decline in the sterling area's gold and dollar reserves. The position was aggravated in the early war years by the need to purchase on a "cash and carry" basis, and the inability of the United States to offer any financial assistance in the form of loans to belligerent countries because of the operation of the Johnson Act. Accordingly special measures were adopted, of which the first was the compulsory acquisition of private dollar balances and the sale of certain investments in America for dollars. It has been estimated that marketable United States securities to the value of $334 million were sold in the United States between 31st August, 1939, and 31st December, 1940. Such disposal of United States investments owned in the United Kingdom was a factor contributing to the United King-

dom's later dollar difficulties as not only the asset but also the income therefrom was permanently lost.

The second special war-measure, Lend-Lease, which became effective on 11th March, 1941, virtually ended the United Kingdom's and sterling area's dollar difficulties as it enabled essential supplies to be procured without regard to the effect on dollar reserves. Lend-Lease was a palliative and not a cure, however, and its cessation in 1945 added substantially to the dollar problem of the sterling area.

The third special measure was put into operation to assist the United Kingdom in her efforts to overcome war-time losses, restore sterling convertibility and achieve balance in transactions with the dollar area. This was the United States dollar loan agreement (December, 1945) under which $3,750 million were advanced to the United Kingdom under comparatively liberal terms. In addition Canada made a loan of $1,250 million and further loans were made by the United States Export-Import Bank.

Immediate Post-war Position

At the end of the war not only the United Kingdom and sterling area countries, but also all European countries (except Switzerland) were faced with an acute dollar problem. The physical destruction of much of their industrial capacity, the loss of pre-war markets, the exhaustion of overseas monetary reserves and the internal monetary inflation intensified the basic causes of their dollar problems, and while the need for imports was higher than ever before the ability to pay for them was much diminished.

The ill-fated attempt to restore sterling convertibility in 1947 amply demonstrated the acute form of the general dollar problem and the inadequacy of the measures so far taken to overcome it. In addition to loans and UNRRA aid these measures took the positive form of drives to increase dollar exports and the negative form of severe restrictions on imports and other dollar expenditure. At the same time action was taken in the United Kingdom to facilitate international trade by extending as far as was practicable the use of sterling as an international currency, and by voluntary agreement among sterling area countries to restrict dollar expenditure in order to build up the sterling area's gold and dollar reserves.

Marshall Aid

Probably the most effective action taken since the war and prior to the currency devaluations in 1949, was the European Recovery Programme (Marshall Aid) through which loans and grants were made by the United States to European countries on condition that the recipients co-operated to assist one another. The main purposes of Marshall Aid were:—

(a) To stave off complete collapse in Europe and make good the dislocation of war;

(b) To restore balance in world trade and thus make possible a return to convertible currencies and multilateral trading;

(c) To promote the political and economic "integration" of Europe.

In the achievement of these objectives Marshall Aid has been largely successful, as evidenced by the progressive liberalisation of inter-European trade, the reduction in dollar deficits, the establishment of the European Payments Union, and the Schuman Plan.

Nevertheless it is a short-term programme and while it has assisted in overcoming the basic causes of the dollar problem other measures were found necessary when the dollar position of Europe and the sterling area, particularly the latter, deteriorated during 1947-49. By far the most important of these was the devaluation of sterling in September, 1949, which initiated the most widespread series of currency devaluations since 1931.

Devaluation

The principal benefit which the sterling area and other countries hoped to derive from the 1949 devaluation was an increase in the earnings of dollar currencies from the sale of exports and from other sources. When the convertibility experiment failed the United Kingdom's gold and dollar reserves had declined and the downward trend continued during 1947 and 1948. In 1949 the decline was accelerated largely as a result of a reduction in dollar earnings due to a slight recession in United States business. The following figures illustrate the progressive decline in the United Kingdom's gold and dollar reserves: From $2,476m. at 31st December, 1945, they declined to $2,079m. at 31st December, 1947, to $1,856m. at 31st December, 1948, $1,651m. at 30th June, 1949, and to $1,340m. at 17th September, 1949.

When it became known that difficulties were arising in regard to the monetary reserves of the sterling area and that a devaluation was probable, the actions of foreign importers of sterling area goods in delaying their orders and payments, and of sterling area importers in trying to expedite their payment added to the strain and made a devaluation almost inevitable. In September, 1949, sterling was devalued 30.5 per cent in terms of the U.S. dollar, i.e., from £1 = $4.03 to £1 = $2.80, and most of the other non-dollar countries followed suit though not all to the same extent.

Improvement in Reserves

In July, 1949, before the sterling-dollar exchange rate was altered, the Finance Ministers of all Commonwealth members of the sterling area (except South Africa which does not participate in the "dollar pool") agreed to limit dollar import expenditure to 75 per cent of the 1948 level. This voluntary limitation of dollar expenditure, devaluation, the promotion of dollar exports and an up-turn in United States business activity, led to remarkable improvement in the dollar position of the sterling area as a whole, and in the position of individual members.

From the low level of $1,340m. at 17th September, 1949, the gold and dollar reserves steadily improved each quarter and at the end of 1950 amounted to $3,300m. In the first quarter of 1951 they further increased by $458m. and in the second quarter by $109m.

The improvement in the reserves resulted in agreement to suspend Marshall Aid to the United Kingdom as from 1st January, 1951.

Changes in 1951 and Prospects

In the second quarter of 1951 the sterling area's gold and dollar reserves rose, as already mentioned, by only $109m. compared with $458m. in the first quarter. This change was attributable to three causes, namely:

(a) the increase in dollar import expenditure due to re-armament and stock-piling programmes;

(b) a reduction of net receipts of gold and dollars from non-dollar countries, largely through the

United Kingdom's position in the European Payments Union; and

(c) a decline in the dollar earnings from exports of the rest of the sterling area.

The effect of the current re-armament programmes on the dollar position of the sterling area and European countries cannot yet be assessed. Increases in the price of commodities imported by the dollar area may compensate for the increased demand for and cost of dollar goods; but the need for restraint in the expenditure of dollars is still evident.

The dollar problem cannot be regarded as solved until there is a balance of transactions between the sterling and dollar areas without any restrictions being necessary to achieve that end. At present, our gold and dollar reserves are too low, the demand for dollars too much in excess of supply, and the basic causes of the dollar problem too far from solution. Those basic causes can only be overcome by increases in the productivity of the rest of the world, an increased flow of private investment from the United States, and increased exports to, and less reliance upon, the United States. Hence continued efforts must be made for an indefinite period before the dollar problem is solved.

VIII - THE STERLING BALANCES

In preceding articles, a number of the post-war difficulties which have confronted the sterling area have been described and analysed; but only passing reference has so far been made to the question of sterling balances, a further problem which has arisen largely as a result of the war. The funds which many countries hold in sterling are naturally regarded by them as assets, but to the United Kingdom they are liabilities. Therefore what are usually referred to as "sterling balances" should more correctly be called "sterling liabilities of the United Kingdom". The official definition is as follows:—

"Sterling liabilities comprise net liabilities of banks in the United Kingdom to their overseas offices and other account holders, including funds held as cover for overseas currencies, and overseas loans to H.M. Government expressed in sterling or sterling area currencies, including the capital value of payments due to India and Pakistan under the Pensions Annuities Schemes of 1948. Private holdings of securities are excluded." In less technical language, they represent all the amounts of sterling currency owned by non-residents of the United Kingdom, plus any debts owed by the United Kingdom Government to non-residents and expressed in terms of sterling. Although no official figures as to their composition are available, most of the sterling balances probably consist of the holdings by overseas banks of deposits with London banks (including the Bank of England), and of British Treasury Bills. They include therefore part of the international reserves of many overseas countries, held by them as statutory backing for their currencies and as working balances to finance international transactions in sterling. The existence of these large sterling balances is thus one manifestation of the widespread use of sterling as an international currency and of the services provided by the London money market.

Wartime Growth in Sterling Balances

In August, 1938 the sterling balances totalled £760 million. During World War II a rapid accumulation of the balances took place, due principally to—

(a) heavy military expenditure by the United Kingdom in countries such as Egypt, India and Ceylon, for the construction of military works such as roads, buildings, harbours, railways and aerodromes and for the maintenance of British troops;

(b) deficits incurred by the United Kingdom in its current exchange transactions with other countries—Britain continued to import raw materials and food, but for military reasons was unable to maintain a corresponding outflow of exports;

(c) the payment of sterling to sterling area countries in exchange for dollars earned through exports (e.g., rubber, tin, jute, tea and cocoa) to the United States, and also for dollars resulting from United States military expenditure in such countries as Egypt, India, Burma, Australia and New Zealand.

In consequence, by December, 1945, holdings of sterling by overseas countries had increased to nearly £3,400 million, the amount held by sterling area countries being approximately £2,450 million. India was then the largest single holder, with about £1,100 million. The largest holder of sterling funds among the non-sterling countries was Egypt, whose balances amounted to approximately £400 million.

Effect of the Sterling Balances

The accumulation of sterling balances in wartime was probably unavoidable, but it left a heavy burden of indebtedness on the economy of the United Kingdom. They represented claims on the resources of the United Kingdom which could (unless special arrangements were made) be used for purchases of United Kingdom goods without any goods being supplied in return. Thus, failing default by United Kingdom or voluntary "scaling down" by the holders, the sterling balances could only be reduced by means of these "unrequited exports" or by allowing the sterling funds to be used to buy other currencies, such as dollars, from the United Kingdom. Neither method could be satisfactory to the United Kingdom, since the first (unrequited exports) would mean the diversion of United Kingdom goods away from the sadly-depleted home market or away from much-needed dollar markets; while the second (convertibility of sterling balances) would have resulted in an immediate loss of precious gold and dollar reserves. The sterling funds thus represented not only a burden on the United Kingdom economy and standard of living, but also an impediment to the restoration of convertibility of sterling.

Two other aspects must be mentioned. One was the fact that, since a large part of the accumulated balances had arisen as a result of heavy military expenditure by the United Kingdom in the defence of

a common cause, this was regarded in some quarters as good reason to cancel such balances as part of an over-all settlement of wartime indebtedness. A second point is that so many countries held large sterling funds which could only be spent in the sterling area or other soft currency countries, that they in fact were disposed to spend them freely. Thus demand for many sterling area goods—many of them already in short supply—was increased and sterling prices tended to rise. The United Kingdom then had to pay more for her imports, and the post-war scarcities of many essential goods were accentuated.

Blocked Balances

One war-time method of relieving the problem created by the accumulated sterling balances was the decision of the United Kingdom Government to block or freeze a portion of them. This action was justified mainly on the grounds that the accretion of the balances was in part due to abnormal transactions, which have already been referred to, i.e., payments the United Kingdom was obliged to make to various countries for military purposes. During the war, holders of sterling assets in general undertook not to use their balances for other than current transactions. The system of blocked sterling, though much modified since the war, still operates.

U.S. Loan Agreement

When Lend-Lease ceased in 1945 and the United Kingdom was faced with a serious dollar crisis, the United States was willing to make a substantial loan to the United Kingdom in order to facilitate the recovery of sterling and the restoration of full convertibility of currencies. It was recognised, however, that the attainment of these objectives was virtually impossible so long as the large sterling indebtedness of the United Kingdom remained. Therefore, in agreeing to make a large sum in dollars available on loan to the United Kingdom, and while imposing an obligation (which the United Kingdom accepted) that sterling should be freely convertible for current transactions after 15th July, 1947, the United States sought also to relieve the United Kingdom of part of the burden of its sterling liabilities. Accordingly, in the Anglo-American Financial Agreement of 6th December, 1945, the Government of the United Kingdom declared its intention "to make agreements, according to the circumstances of each case, for an early settlement covering the sterling balances accumulated by the sterling area and other countries". The agreement proposed that the settlements with the sterling area countries be on the basis of dividing the accumulated balances as follows:—

1. Those to be released immediately, and convertible into any currency for current transactions.
2. Balances to be blocked but subsequently released over a period of years beginning in 1951; the released balances to be freely convertible for current transactions.
3. Balances to be "adjusted" as a contribution to the settlement of war and post-war indebtedness and in recognition of the benefits which the countries concerned might be expected to gain from such a settlement. (This clause implied a "scaling-down" of the sterling balances.)

The financial position of the sterling area since 1945, especially *vis-a-vis* the dollar area, prevented the fulfilment of some of these provisions in the loan agreement. The free convertibility of sterling into dollars was restored in July, 1947, but the experiment was not a success. Convertibility of sterling was again suspended in August, 1947, and has not since been restored.

No agreement has so far been reached for a scaling down of the sterling balances as suggested by the Financial Agreement. Unilateral action in this direction by the United Kingdom is out of the question, and none of the holders of the balances has as yet been prepared to agree to a step of this nature. However, New Zealand and Australia have made gifts to the United Kingdom of £10 million and £25 million sterling, thereby reducing the latter's sterling liabilities to a small extent.

Release of Blocked Balances

That part of the Financial Agreement relating to the progressive releases of sterling balances has been carried out, the United Kingdom having made a series of agreements with many of the countries concerned (especially those with the largest balances). Those agreements usually specify the amounts of blocked sterling which will be released by the United Kingdom in a given period and in some cases indicate the extent to which free balances may be converted into dollars.

The size of the blocked sterling holdings in recent years may be appreciated when it is realised that at the end of 1949, an estimated £1,286 million, or nearly 38 per cent, of the total sterling balances fell within this classification. The largest holders of such balances at that date were India, Egypt, Pakistan and Iraq, their frozen funds amounting respectively to £680 million, £253 million, £130 million, and £82 million.

The sterling balances are customarily held at the Bank of England in two accounts—a No. 1 Account consisting of free balances which may be drawn upon by the countries to whose credit they stand, for the purpose of financing current transactions; and a No. 2 Account, comprising the blocked or frozen funds. When any part of the latter is released by agreement, it is transferred from the No. 2 to the No. 1 Account of the country concerned, thus augmenting the amount of the holder's free funds.

An example of the form these releases may take is afforded by the financial agreement recently reached between the Governments of Egypt and the United Kingdom. This agreement permits the release of £150 million of Egypt's blocked balances (which at the time of the negotiations totalled approximately £230 million), over a period of between ten and thirteen years, commencing in 1951. In each of the ten years 1951-60 inclusive, there will be a release of £10 million to Egypt, who will also have the right to draw a further £5 million per annum up to £35 million, should the balance in its No. 1 (free) Account fall below £45 million. In addition, there is provision for special releases, including one of sterling against which dollars may be made available. Should any part of the £35 million mentioned above remain outstanding at the end of the tenth year, it will be released to Egypt at a rate of £10 million over the three years 1961-63, with the payment of any outstanding amount in 1963

as may be necessary to liquidate the £35 million. The future of the frozen balance of £80 million still remaining to Egypt's credit will be the subject of discussions between Egypt and the United Kingdom before the expiry of the present agreement.

Further substantial releases are contained in the Colombo Plan for the economic development of South and South-East Asia. Part of the projected financing of this programme will include releases from the blocked funds of India, Pakistan and Ceylon over the six years 1951-57. It is expected that the blocked holdings of these countries will decline by a total of £246 million during this period.

Changes in Sterling Balances

Changes in the balance of payments of the various countries holding sterling balances bring about fluctuations in the total of those balances and in their ownership. This is shown in the following table, which indicates the tendency in recent years for the sterling holdings of sterling area countries to increase relative to those of non-sterling countries.

The balances are now appreciably higher than in 1945. In money terms, the burden they impose on the economy of the United Kingdom has thus increased, but in real terms it is less than in 1945 because of the price increases which have since occurred.

DISTRIBUTION OF U.K. STERLING LIABILITIES

(£ millions) *Source: U.K. White Papers, Cmd. 8201, 8354 and 8379*

	June 1945	Dec. 1946	Dec. 1947	Dec. 1949	Dec. 1950
TO NON-STERLING COUNTRIES					
Dollar Area	50	35	18	31	79
Other Western Hemisphere	144	213	235	80	45
O.E.E.C. (European) countries	417	424	480	439	395
Other non-sterling countries	611	632	573	515	494
(A) Total—non-sterling countries	**1,222**	**1,304**	**1,306**	**1,065**	**1.013**
TO STERLING AREA COUNTRIES					
Dependent overseas territories	391	495	510	583	754
Other sterling countries	1,741	1.922	1,787	1,769	1.976
(B) Total—sterling countries	**2,132**	**2,417**	**2,297**	**2,352**	**2,730**
(C) Total—sterling liabilities to all countries*	**3,354**	**3,721**	**3,603**	**3,417**	**3,743**
Percentage—sterling area (B) to total (C)	64	65	64	69	73

* Excludes sterling liabilities to international organisations such as the I.M.F.

IX - INTERNATIONAL CAPITAL MOVEMENTS

In discussions of the balance of international transactions a distinction is usually made between "current" and "capital" items. A "current" transaction is one in which money is transferred in exchange for goods or services rendered; or one which is of a unilateral nature (e.g., gifts, donations, pensions, legacies, etc.) where no goods change hands and no services are rendered, but no debt results. "Capital" transactions are those which bring about a change in international indebtedness, whether on government or private account. A country which receives a capital remittance incurs an obligation to repay; the capital-exporting country acquires an asset abroad in the form of property, or securities or some other right to repayment. Capital movements also include repayment of previous borrowings. Thus every international capital transaction results in a change in the pattern of international assets and liabilities.

The borrowers and lenders concerned might be governments or local bodies, business firms, banks, international organisations, or individuals. In recent years governments and international organisations have played a much greater part than previously.

The methods by which capital movements can take place are many. For example, governments may lend to each other by means of cash transfers, with or without specifying in what country or for what purpose the funds might be spent; or they may supply goods and services to each other and claim payment later; or one government may raise a public loan by issuing securities in a foreign market. A company may lend to a subsidiary company abroad by transferring cash, or by supplying machinery, equipment, trade secrets, or technical staff receiving in exchange share capital or debentures. Individuals or companies may buy securities or property in a foreign country, or may merely acquire a cash balance in foreign currency. If, for example, a person migrates from Australia to New Zealand and retains ownership of property in Australia, New Zealand will thereby have acquired an overseas asset.

Some of the capital movements mentioned above (the list is not exhaustive) involve banking transactions in the form of purchases and sales of foreign currency through the banking system, and in New Zealand these are recorded in the analysis of foreign exchange transactions published by the Reserve Bank. In these tables capital receipts are divided into:—

(a) those which increase New Zealand's external liabilities (i.e., overseas borrowing); and
(b) those which reduce New Zealand's external assets (i.e., proceeds of sale of overseas property or securities, or repatriation of cash balances).

Similarly, capital payments are divided into—

(a) those which decrease New Zealand's external liabilities (i.e., repayment of debts due overseas); and
(b) those which increase New Zealand's external assets (i.e., acquisition of property or securities in overseas countries).

It should be noted that these changes in external assets and liabilities do not relate to those of the banking system, which in fact show offsetting changes. For example, if a New Zealand resident purchases sterling from a local bank in order to repay a debt due in the United Kingdom, private overseas liabilities are thereby reduced, but the sterling assets of the bank are similarly reduced.

Those international capital movements which do not involve dealings in foreign currency by the banking system are more difficult to ascertain and are not covered by the Reserve Bank's analysis. However, the Government Statistician has recently begun an inquiry into these transactions.

To a country which is importing capital, international investment provides funds or goods (or both) which have not had to be earned by way of exports, and additional means are thus available for the development of resources and industries. Normally the result should be beneficial to the recipient country and should enable it to meet the necessary interest payments and the eventual repayment of the initial investment. To the capital-exporting country there is a net drain on its resources, as goods and services are in effect being provided to other countries without any compensating goods or services being received until considerably later. Thus a country cannot afford to allow capital export unless its balance of payments position is healthy with a tendency to a surplus of receipts over payments. For a country whose balance of payments is in chronic deficit, especially in relation to hard currencies, controls are usually applied to outward movements of capital.

The flow of long-term capital is normally from the more highly developed and industrialised countries to those which are relatively undeveloped, or from one developed country to another. Short-term capital movements, however, are more irregular, and in some periods have been a disturbing factor in international finance. What is usually called "hot money" has moved in large amounts from country to country, motivated by the desire of its owners to speculate on changes in exchange rates, or to take advantage of differences in interest rates, or to avoid political troubles. Exchange controls now seek to prevent such movements of capital.

Recent History of Capital Movements

During the 19th and early 20th centuries, international investment was mainly undertaken by private institutions and persons, governments playing a minor role. Up to 1850, such investment was largely confined within Europe, with the United Kingdom making substantial contributions in the form of capital goods and equipment to the relatively less developed countries on the Continent. In consequence of the growing industrialisation of Europe, however, and the opening up of overseas territories, the flow of British capital into Europe diminished and instead was directed to an increasing extent to the exploitation of the natural resources of areas as yet undeveloped. The shift in British investment to these countries was accompanied by similar action on the part of other European nations, which also began to lend abroad. Whereas in the 1850's approximately 60 per cent of British overseas investments were in Europe, by 1913 more than 85 per cent were in non-European countries largely dependent on the production and export of primary commodities. The decline in United Kingdom investment in Europe represented a decrease in absolute value of more than one-half, while British holdings elsewhere rose more than fivefold. The gap left in Europe through the withdrawal of British capital was covered by increased investment of French and German origin. The United Kingdom up to 1914 remained the largest single international investor, because Britain had commenced investing overseas on a substantial scale before other nations. The growth of international investment during this period was also an important factor leading to a marked expansion in the volume of international trade.

The first World War caused a considerable change in the character of foreign investment and in the relative positions of the leading creditor nations. Germany lost almost all her pre-war foreign holdings and France nearly one-half. The reduction in the United Kingdom's investments compared with 1913 exceeded 20 per cent, a large part of this fall representing the liquidation of British-owned United States securities to help pay for supplies from North America.

The United States emerged from the war as a large creditor nation. While the investments held by European nations had declined after 1914 the United States increased the scale of its lending, both private and public. Before the war, the value of United States investments abroad totalled U.S.$3,800 million, compared with U.S.$6,800 million of foreign-owned funds invested in the U.S.A. By 1919, private American long-term capital overseas alone was estimated at U.S.$6,500 million and in 1921, United States loans on a government-to-government basis had reached the vicinity of U.S.$10,000 million.

In the first decade of the inter-war period, the United States was the major supplier of both government and private foreign loans and investments. The direction of flow of funds again changed, and capital, this time mostly from North America, once more moved towards the more industrialised countries of Europe. Much of these funds comprised large scale American Government loans to war-damaged or newly-formed states on the Continent. With the return of a measure of stability in Europe, however, private loans and investments expanded, including not only those of the United States origin, but also those of several of the pre-war capital-exporting nations.

A particular feature of the 1920's was the high percentage of short-term capital involved in foreign private transactions. Of the equivalent of U.S.$7,500 million borrowed by Germany up to 1930 (approximately half of which came from the U.S.A., and the remainder mostly from other European sources), more than 40 per cent was on a short-term basis. Investors apparently sought the greatest measure of security for their holdings, i.e., loans to governments or government-guaranteed credits, and quick withdrawal in the event of a return of economic or political instability.

The flow of private American short-term capital to Europe continued until the second half of 1928, when the greater attraction of United States domiciled bonds resulted in a sharp drop in American buying of foreign securities. This reversal in the movement of American capital was intensified following the Wall Street crash in 1929. Short-term capital lent to European countries was withdrawn, thereby accentuating the internal and foreign exchange difficulties of the

borrowers and contributing to the breakdown of the gold standard in 1931.

In the 1930's the steady outflow of capital from creditor nations virtually ceased, this being a period of depression, political unrest, nationalistic policies, high tariffs, and exchange controls. Even the general recovery in the latter part of the 1930's, which was sustained by rearmament in many countries, failed to revive significantly the flow of international investment.

Post-War Policies

Since the end of World War II, the United States has been the principal creditor nation and the main source of new funds. During 1939-45, foreign countries sold a substantial amount of their long-term investments in the United States but, through the subsequent operation and annulment of Lend-Lease, that country did not conclude the war with large credits outstanding as in 1918. The pattern of international investment after 1945 is mainly one of large-scale lending by the United States Government to European countries, supplemented by credits from the Canadian Government and the newly-formed International Bank for Reconstruction and Development. There has also been an increase in private American investment overseas but this has been overshadowed by the outflow of government capital. The capital contribution, both public and private, of other countries to and within Europe has been almost negligible by comparison, although certain of these governments (including the United Kingdom) and their agencies appear to have invested fairly extensively in their own overseas territories and associated currency areas.

Nearly 85 per cent of the total net outflow of American long-term capital, excluding grants, between 1946 and 1949, amounting in the aggregate to U.S.$14,000 million, was provided by the U.S. Government, substantial items in this category including the U.S.$3,750 million loan to the United Kingdom; Export-Import Bank loans; credits under the European Recovery Programme; and the United States subscriptions to the International Monetary Fund and the International Bank. Movements of private short-term capital have been small and in 1948 the United States was a net importer of such funds. Possibly indicating the return of a measure of stability in international economic relationships, the net outflow of United States private long-term capital in 1950 rose by almost 50 per cent compared with 1949, while the net outward movement of U.S. Government long-term capital in 1950 was more than 70 per cent less than in the previous year, mainly due to reduced lending under the European Recovery Programme.

Several developments in the period since 1945 deserve some attention:—

(a) The entry of Canada into the international investment field as a large-scale lender. Although Canadian net private investment abroad has been small, the Canadian Government since 1945 has granted loans to European countries to the extent of nearly Can.$1,800 million.

(b) The establishment of the International Bank for Reconstruction and Development, which began operations in 1947 and has since made loans amounting to over $1,100 million. During the first two years of its operation, almost all the Bank's long-term loans were made to assist the reconstruction of European economies, but more recently (mainly owing to the fact that the task of rehabilitating Europe has since been undertaken through Marshall Aid) most of the credits from the Bank have been for the purpose of promoting the economic advancement of underdeveloped nations.

(c) The attempt, through the proposed International Trade Organisation, to establish a code of rules covering international investment, setting out the rights and obligations of private investors on the one hand and those of the capital-importing countries on the other. So far no formal agreement has been achieved in this direction.

(d) The establishment of other large-scale international schemes for the economic development of the less developed countries of the world. Those most worthy of mention are—Marshall Aid; President Truman's "Point Four" Programme; the "technical assistance" programme of the Economic and Social Council of the United Nations; the Economic Commissions (also under the Economic and Social Council) for Europe, Asia and the Far East, and Latin America; the "Colombo Plan", and the South Pacific Commission. Though the economic development of many countries has scarcely begun, these organisations have already produced results and justify the belief that progress will be faster in the future. In terms of human welfare, economic prosperity and political stability, much depends on their success.

X - EQUILIBRIUM IN THE BALANCE OF PAYMENTS

Earlier articles in this series described *inter alia* the methods by which international payments were made, and explained how exchange dealers (in New Zealand the trading banks and the Reserve Bank) buy and sell foreign currency in exchange for domestic currency. When, over a given period of time, dealers' purchases of foreign currency exceed their sales, the result is normally an increase in their reserves of foreign exchange and the country concerned is said to be "in surplus" or to have a "favourable" balance of payments. Conversely, when dealers sell more foreign currency than they purchase the result is normally a "deficit" or "unfavourable" balance of payments and a fall in external reserves.

In some countries, however, most international transactions are financed not in foreign currency but in domestic currency. A distinction between the use of foreign and domestic currency is important, as the extent to which one or the other is used directly affects the level and nature of the international reserves a country must hold. For example, New Zealand's domestic currency does not serve as a medium of in-

ternational exchange, mainly due to our relatively small share of total world trade and payments, and our international transactions are settled in foreign currency, principally sterling. Our "net overseas assets" vary with changes in our balance of payments—rising with a surplus and falling with a deficit—and accordingly must be adequate to meet seasonal and other fluctuations. The position of a country like the United Kingdom is slightly different. To the extent that sterling—her domestic currency—is used to finance her international transactions, a surplus or deficit in the balance of payments is reflected by a rise or fall in the sterling balances held by other countries. These balances constitute a United Kingdom liability. However, in cases where foreign currency is used, notably in the United Kingdom's trade with the dollar area, adequate reserves must be held, either of gold or dollars or both. The United States is an example of a country whose domestic currency finances most of her international payments and movements in the United States balance of payments are therefore reflected in the reserves of gold or dollars held by other countries.

Thus in relation to a country's international reserves the importance of a deficit or surplus in the balance of payments will vary according to that particular country's need for such reserves. With New Zealand foreign currency reserves are essential; with the United Kingdom reserves of gold and dollars are also essential but due to the wide transferability of sterling reserves of other foreign currencies need not be so substantial; while in the case of the United States the domestic currency is so much in demand by the rest of the world that there is no need to hold large foreign exchange balances.

To assess the causes and seriousness of a disequilibrium in the balance of payments, and to decide what corrective measures can and should be put into effect, it is first necessary to define equilibrium. In one sense receipts and payments in foreign currency must always be in balance since exchange transactions involve the exchange of one currency for another. A customer disposes of currency "A" in order to obtain an equivalent amount of currency "B"; the dealer disposes of currency "B" and acquires currency "A". However, a dealer may be called upon to sell in a given period more foreign currency than he has bought, and therefore will be required to use up some reserves, or to borrow foreign currency specially to meet the situation. Thus it is necessary to differentiate those items in the balance of payments which represent normal transactions undertaken for their own sake from those, the presence of which, as net balancing items over a period of time, may indicate a disequilibrium. Such transactions as gold movements, special borrowing, and changes in official reserves of foreign currency or in external liabilities take place when the normal transactions on trade and income account (i.e., export and import of goods and services, and normal capital movements) do not balance by themselves, and accordingly are in the nature of net balancing transactions. It is necessary to exclude them from the balance of payments in order to obtain a definition of equilibrium.

Transactions included in the balance of payments may be divided into "current account" and "capital account" items. Included in the former are receipts and payments for goods and services, and also "unilateral" transactions; while the latter include the normal capital movements. If current payments exceed current receipts the resulting deficit may be offset by a surplus in the capital account. The converse is also true. However, if the current account deficit is not balanced by a capital account surplus the balance is settled either by special borrowing or by a decline in overseas reserves (including gold) or an increase in overseas liabilities. It is the movement in international reserves which is the true criterion of equilibrium or disequilibrium in the balance of payments.

It is necessary to elaborate this definition, however, as though overseas receipts and payments may be in balance, this may be due to an inflow of short-term "hot money" or to special external borrowing, or to the application of rigorous exchange controls, or to manipulation of the exchange rate, or to an internal deflation which, by reducing incomes and costs, stimulates exports and discourages imports. Hence true equilibrium in a country's balance of payments may be said to exist when its international currency reserves are adequate and stable over a period of time without:—

(a) the use of trade and exchange controls;
(b) deliberate and sustained deflation;
(c) special borrowing;
(d) frequent changes in exchange rates;
(e) an inflow of "hot money".

Stability in monetary reserves could be achieved by any one of the measures listed above, but it would not be true equilibrium.

Under present conditions, changes in the balance of payments that may cause a disequilibrium are more likely to occur in current account rather than capital account transactions, since the latter are subject to exchange control in most countries.

Causes of a Deficit on Current Account

As previously mentioned, the current account includes payments for imported goods and services, and receipts from exported goods and services. The balance between exports and imports is referred to as the trade or "visible" balance, while other transactions such as travel, investment income, insurances, are referred to as "invisible" items. The relative importance of these two types of transactions varies from country to country. For instance, in New Zealand the "visible" balance is by far the more important so that a deficit or surplus results mainly from changes in the value of exports or imports. The main causes of a deficit in the current account may be summarised as follows:

(a) ***Reduced receipts,*** which may result from a fall in export income or a decline in "invisible" receipts. A country's export income can decline for a variety of reasons—the demand for its exports may fall due to depressed markets in the countries it supplies, increased volume of substitute commodities, or larger supplies from competing countries; or seasonal conditions may reduce supplies of farm produce. Thus the re-entry of Japan into world trade may affect the export markets of other exporters of manufactures. It is also possible, for example, that the increased production and use of man-made fibres may affect the overseas incomes of wool-exporting countries. Another reason for a decline in a country's exports may be increasing local demand for its export goods, as a result of internal inflation or a growing population. For example, in the United Kingdom direct controls

were necessary to ensure that a high level of local demand did not divert export goods, such as cars, to the home market; while Australian exports of meat and dairy produce are tending to decline for similar reasons.

Internal inflation not only diverts goods to the home market but also pushes up the cost of producing exports. This may mean higher export prices, but the higher prices may cause a more than proportionate decline in external demand, so that the total value of the exports may fall.

A further factor, which has accentuated the problems of European countries in increasing their exports and thereby improving their balance of payments, has been the physical damage their export industries suffered during the recent war. In addition to these losses the war also caused a fall in invisible receipts, as overseas assets were sold and the income therefrom permanently lost.

(b) ***Increased Imports.*** In addition to diverting export goods to the home market, internal inflation, by increasing local incomes, stimulates the demand for imported goods and services, and is probably the most important single factor causing disequilibrium in a country's balance of payments. Imports may also rise as a result of special factors such as military needs or capital development. A further factor that could cause a substantial rise in the volume and value of imports would be a fall in local production of essential goods, particularly foodstuffs.

Thus there is a complex of factors that can operate to increase a country's overseas expenditure on imports. At the same time they may affect its capacity to export. The effects on the balance of payments through the operation of each of these factors cannot be quantitatively measured in advance, but their influence will show in movements in a country's international reserves or liabilities.

A deficit resulting from a high level of import payments or too low a level of current receipts, as has already been stressed above, does not necessarily indicate a lack of equilibrium. Certain capital items must also be considered before movements in international reserves can be regarded as evidence of disequilibrium.

Causes of Deficit in Capital Account

The previous article in this series has described the methods by which capital movements take place. The main causes of disequilibrium in a country's balance of payments originating from capital transactions may be summarised as follows:—

1. Payments in respect of overseas debts and reparations;
2. A disparity in the interest rates in different countries for long-term investments, which, other things being equal, and in the absence of control, will cause a movement of funds from the low to high rate countries;
3. Erratic movements of "hot money" in search of either political security or profits from exchange speculation:
4. Sudden changes in the flow of long-term capital for genuine investment purposes.

The first of these may place a burden on a country's economy, but the amount involved is definite and foreseeable, and plans can be made accordingly. The second is not subject to sudden changes and in these days is usually prevented by exchange controls. The third, is the most dangerous in troubled times, since it is often unpredictable. It is the outward flow of "hot money" which usually causes difficulties, but recent Australian experience has shown that an inward flow can also be an embarrassment. The fourth factor was important in the late 1920's when the flow of capital from U.S.A. to Europe ceased.

Action to Correct a Disequilibrium

To some extent a disequilibrium in external receipts and payments will tend to correct itself in time. Provided the situation is not serious and monetary reserves are adequate, little might be needed in the way of corrective action by governments or central banks. For example, assuming that overseas transactions are initially in balance, an increase in export prices in New Zealand will so increase farm incomes in particular, and the total national income in general, that there will be (after a time lag of some months) a greater expenditure on imports and the balance of trade will tend to be restored. Similarly a drop in export prices will tend to bring about a decline in incomes and in the demand for imports. So long as the export price changes are moderate, the only other change that need occur is in the level of overseas assets of the banking system. Before 1934 (when the Reserve Bank commenced business) the trading banks in New Zealand dealt with fluctuations in export receipts by making small changes in exchange rates, by altering the rate of interest on bank overdrafts and adjusting their credit policy generally, thus reinforcing the tendency for the balance of payments to adjust itself.

When more violent changes occur in a country's balance of payments, more drastic action may have to be taken. Possible measures include:—

1. Special external borrowing to help maintain a desired flow of imports;
2. Alteration in exchange rates;
3. Taxes and subsidies designed to influence external trade;
4. Exchange and import controls;
5. Disinflationary policies designed to reduce monetary demand.

XI - REMEDIES FOR BALANCE OF PAYMENTS DISEQUILIBRIUM

In considering what is the appropriate action to take to deal with a serious deficit in the balance of payments, these points must be kept in mind:—

1. The choice of action cannot be made a long time in advance. Each situation must be dealt with on its merits; no two situations are the same.
2. The objective is to achieve not an artificial stability in monetary reserves, but a true equilibrium, as defined in the previous article.
3. There may be a conflict between the objective of equilibrium in the balance of payments and other objectives, such as internal price stability or full employment.

It is useful to distinguish between three types of

action which might be taken. First, there are measures of a "stop-gap" nature, i.e. to stop a serious decline in monetary reserves by a system of controls, but without doing anything to correct the basic causes of the disequilibrium. Secondly, there are corrective measures which try to go to the root of the trouble and to restore true equilibrium. Then there is a third type—the major surgical operation undertaken when the other methods have either been rejected on other grounds or have failed to produce sufficient results—namely currency devaluation.

Stop-gap Measures

(a) External Borrowing: When the deficit in the balance of payments, though serious, is likely to be temporary, external borrowing could provide useful relief and avert the need to adopt more severe measures, such as exchange restrictions or devaluation. However, a country with falling monetary reserves does not look a good risk to would-be lenders, and borrowing may be difficult. It was partly to meet such situations that the International Monetary Fund was set up. The intention is that member countries whose reserves of foreign currency are temporarily inadequate can, in effect borrow on short term from the Fund, and thus will not need to adopt restrictive measures harmful to international trade.

Borrowing for long periods would undoubtedly assist the balance of payments, but is justified rather as a means to economic development than as a device for safe-guarding monetary reserves. The economic development might, in the long run, stimulate exports and provide substitutes for some imports, but these effects are remote and uncertain.

(b) Taxes and Subsidies: It is possible for a country which is in deficit to try to restore balance by stimulating exports with subsidy payments, or to discourage imports by means of taxes. Such methods have the advantage that they can, if necessary, be applied selectively, in relation both to different commodities and to different countries. On the other hand they are slow and uncertain in their effects, and the question of their adoption has to be decided on the basis of the consequences not only on the balance of payments, but also on public finance, incomes, protection of local industries, and prices. Taxes and subsidies are seldom used as a device to restore equilibrium in the balance of payments.

(c) Exchange and Import Controls: There is a wide variety of possible methods by which controls can be applied to external transactions; but they have the same general purpose, namely the rationing of foreign currency in order to keep payments down to the level of the funds available. Usually there is a partial or complete mobilisation of receipts of foreign exchange so that the maximum funds are available for rationing; and there is a system of priorities in respect of payments so that the more important or urgent needs can be met first, special attention being given to restrictions on capital transfers. The administration of the rationing system may be in the hands of a Governmental authority issuing import licenses, or of a banking authority issuing permits to buy foreign currency. In some countries the system is further complicated by such devices as multiple exchange rates (i.e. different rates for different classes of transactions), special exchange taxes, or free markets for permits to buy foreign currency.

Exchange and import restrictions, as a remedy for balance of payments deficits, possess both advantages and disadvantages. The main advantages are that they can be applied quickly and selectively, discriminating against luxuries in favour of essential goods and services and if necessary discriminating between foreign currencies. They are also flexible, so that they can readily be adapted to changing circumstances.

The principal disadvantages of exchange and import restrictions are that they involve considerable administrative work and individual decisions, and that they do not change the underlying causes of an unfavourable balance of payments. Hence unless other measures are used or some fortuitous circumstance such as a rise in export prices occurs, they are more in the nature of a palliative than a cure. Their relaxation or complete removal tends to become difficult. For this reason they are more suited to counteracting a temporary or short-term disequilibrium than correcting one that is "fundamental".

A further disadvantage of exchange restrictions is that when the quantity of imported goods is regulated by administrative procedure scarcities may result and prices tend to rise.

Despite these disadvantages exchange and import restrictions are probably the most effective way to prevent a loss of reserves, especially if proper corrective action is taken at the same time and the restrictions are removed as soon as possible.

Import restrictions are recognised as a legitimate measure in Article 12 of the General Agreement on Tariffs and Trade, which permits a country to adopt import restrictions to the extent necessary "(i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or (ii) in the case of a country with very low monetary reserves, to achieve a reasonable rate of increase in its reserves."

The same Article in G.A.T.T. also recognises that a country's domestic policies relating to full employment or economic development may so stimulate imports and reduce exports that a balance of payments deficit results, and import restrictions become necessary. It allows countries to maintain import restrictions even though they could be rendered unnecessary by the abandonment of those domestic policies. It is made clear, of course, that any restrictions which are adopted should be no more severe than is absolutely necessary and should not discriminate—except to the extent required by currency conditions—between different countries. It is assumed, too, that domestic policies of full employment and economic development should be soundly financed.

Corrective Measures

In the previous article on "equilibrium" it was stated that internal inflation is probably the most important single factor causing disequilibrium in a country's balance of payments. An obvious deduction would be that disinflation is the best remedy. However, disinflation cannot be achieved over-night, and it may be necessary to adopt "stop-gap" measures in order to give time for disinflationary policies to be put into effect. Inflation is the condition in which total demand for goods and services at current prices exceeds the supply. Disinflation is the process of removing the excess demand, since in the short run supply cannot be significantly increased. The methods

of disinflation lie outside the scope of this article. The justification for it lies in its stabilising effect on demand and prices, including the demand for foreign currency to pay for imports. One essential point—and one which distinguishes modern economic policy from that of the gold standard days—is that the process of disinflation should not be carried to the point where unemployment becomes a problem. At that point it is probably preferable, in terms of human welfare, to have exchange and import controls or even devaluation rather than chronic unemployment. Under gold standard conditions if gold was lost through an adverse balance of payments, a contraction in economic activity and prices was induced by the remedial measures of the banking system, until balance was again restored. The result was that some degree of domestic stability was sacrificed in the interests of external equilibrium. Since the abandonment of the gold standard, countries have placed increasing emphasis on policies of internal stability and full employment, so that measures to prevent a loss of monetary reserves have been adopted in the light of their effect on these objectives.

Devaluation

An exchange rate which may be appropriate in one period may later become inappropriate because of changing circumstances. In these days it is not uncommon for a currency to become "over-valued", i.e. its value in relation to other currencies is too high, the struggle to achieve equilibrium in the balance of payments imposes too severe a strain on that country's economy, and "devaluation" becomes necessary. Evidence of over-valuation of a currency can be seen in difficulties experienced in selling exports at prices remunerative to producers, owing to a deficiency of demand in export markets or to excessively high production costs; in a tendency for export commodities to be absorbed in the home market; in an abnormally high demand for imports; and in a need for import restrictions so severe that standards of living suffer and industries are dismissing workers because of inability to obtain enough raw materials. If the "stop-gap" measures have been tried, if the Government has gone as far with disinflation as it is willing, and the decline in monetary reserves continues, then devaluation of the currency is likely to be decided upon. Once the possibility of devaluation is realised there will be a "flight" from the currency, i.e. a rush to sell holdings of it before the exchange value of those holdings is reduced. This in itself will so reduce monetary reserves further that the possibility of devaluation becomes a probability. The effect of devaluation is usually—

(a) to end the rumours of devaluation and thus to put an end to the "flight" from the currency (assuming that the degree of devaluation is adequate and that no further downward changes are expected);

(b) to put up the cost (in terms of local currency) of imports and thus to discourage expenditure on imports;

(c) to enable exporters to reduce the price of their goods in terms of foreign currency and thus to increase the volume of their sales.

It does not necessarily follow that, in every situation of over-valuation of a currency, devaluation provides a complete remedy, or is wholly beneficial in its effects. Much depends on world market conditions, the response of demand to changes in prices of exports, and the ability of the country concerned to expand the supply of exports. It is also important that the country concerned should not regard devaluation as a means of avoiding the need for disinflationary action. Nevertheless devaluation is regarded by the International Monetary Fund—the inter-governmental body concerned with the exchange rates of member countries—as permissible, and even appropriate action in certain circumstances. Article IV of the Fund Agreement states that the Fund must approve a proposed change in the rate of exchange of a member country's currency "if it is satisfied that a change is necessary to correct a fundamental disequilibrium". What constitutes a "fundamental", as distinct from a temporary or slight disequilibrium, is nowhere officially defined, but presumably it corresponds roughly with the condition of persistent over-valuation as described above.

In this short space it is not possible to analyse in any detail the *pros* and *cons* of devaluation, exchange controls, and so on. This article merely serves to outline what action might be adopted to deal with disequilibrium in a country's balance of payments.

XII - HISTORY OF EXCHANGE CONTROL IN NEW ZEALAND

Before December, 1938, there was no formal exchange or import control operating in New Zealand. The trading banks freely bought and sold foreign exchange and for this purpose held overseas funds, mainly in London. Before August, 1943, the figures for these "net overseas assets" were not published. If at any time the banks' holdings of overseas exchange fell below a figure which experience had shown to be necessary for normal business operations, they operated an indirect and informal exchange control in order to restore equilibrium in the balance of payments. The methods they used were threefold:—

1. They made frequent small changes in the price at which they would buy and sell foreign currencies (i.e., the exchange rate). When the balance of payments was adverse and they were losing overseas exchange reserves the banks would raise the price of sterling; when the balance of payments was favourable and their reserves were rising they would lower the price of sterling. Although changes were frequent the sterling rate at no time differed from parity by more than 3 per cent either way; except after 1930 when the first steps in devaluing the New Zealand currency were taken.
2. The banks varied the rate of interest charged on customers' overdrafts, and revised their policy in respect of overdrafts. A rise in the interest rate and a tighter lending policy would tend to reduce imports; a lower rate and a freer lending policy would stimulate imports.
3. The banks took a keen interest in their cus-

tomers' transactions in respect of expenditure on imports, encouraging or discouraging them as the banks' interpretation of circumstances required.

The measures adopted by the trading banks, as outlined above, were sufficiently effective to make it unnecessary for the government to apply more direct controls over imports and foreign exchange transactions.

In 1936 the Government of the day began to raise incomes, bring about full employment, develop national resources, and to finance this expenditure programme where necessary by the use of bank credit. A large public works programme was adopted, including state housing on a large scale, and substantial sums were borrowed from the Reserve Bank. By the end of 1936, £1.8 million had been advanced by the Reserve Bank to the State for purposes other than the financing of guaranteed prices for dairy produce, and this amount increased to £12.2 million by the end of March 1939, £5.6 million of which was on account of the government housing programme. During the same period wages were increased, the 40-hour week was introduced, and the general levels of incomes, consumption and production were raised. By the end of 1937 unemployment had virtually disappeared. This was a period of rising export prices (up to November, 1937) but imports were rising faster in response to the increased demand, secondary industries in New Zealand, although expanding, being unable to meet all additional needs. In the circumstances it was inevitable that the "net overseas assets" of the banking system should decline. The following table illustrates the situation which developed:—

(£N.Z. millions)

Calendar Year	Exports	Imports	Excess Exports	Net Overseas Assets at end of year
1936	56.8	44.3	+12.5	29.3
1937	66.7	56.2	+10.6	23.7
1938	58.4	55.4	+ 3.0	7.6

Thus the decline in net overseas assets during 1938 was due in part to a temporary decline in export receipts (a world-wide recession in prices having occurred) and to the high level of imports stimulated by the internal economic policy of the government.

A further factor tending to reduce the level of New Zealand's overseas funds during this period was the withdrawal of capital both by residents and non-residents. The causes were partly political but there was also a withdrawal of funds which had been brought to New Zealand or left here in anticipation of the restoration of the New Zealand pound to parity with sterling. By 1938 the prospect of this happening in the near future had almost completely disappeared. No official figures or estimates are available of the outflow of capital from New Zealand in the years 1935 to 1938 but unofficial estimates place the figure at approximately £20 million.

The decline in net overseas assets during this period illustrates the close connection (more marked in New Zealand than in most other countries) which exists between the internal monetary policy of a country and its external balance of payments. As incomes and bank credit increased, net overseas assets contracted by the end of December, 1938, the net overseas assets of the banking system had dropped to £7.6 million, of which the Reserve Bank held £5.4 million and the trading banks £2.1 million. In fact overseas funds had become so short that trading banks had to borrow temporarily in London to meet their commitments. The reserve ratio of the Reserve Bank (i.e., the ratio of gold plus sterling funds to notes issued and other demand liabilities), which by statute was then required to be not less than 25 per cent, was kept over that figure only with difficulty. The situation had become so serious that emergency action had to be taken.

On 5th December, 1938, by Order-in-Council, two regulations were made—"The Export Licences Regulations, 1938" and "The Import Control Regulations, 1938". They were published in the New Zealand "Gazette" in a special supplement on 6th December, simultaneously with the "Sterling Exchange Suspension Notice", and on 7th December all three came into effect. The Sterling Exchange Suspension Notice removed the statutory obligation of the Reserve Bank to give sterling in exchange for Reserve Bank notes and thus prepared the way for a system of exchange control, while the export and import control regulations placed all our external trade under a system of licensing.

The export control regulations made it unlawful to export goods from New Zealand without a license issued by the Customs Department, and required that all foreign currency proceeds of the sale of exports should be sold to the Reserve Bank or its agents (the trading banks being appointed agents for this purpose). The intention was not to restrict exports (a maximum value of exports was obviously needed to help to remedy the balance of payments situation) but to ensure that all available funds from this source were brought into the banking system. The import licensing system (licenses issued by the Customs Department) was designed to curtail imports to the extent necessary to restore net overseas assets to a better level. The exchange permit system introduced by the Reserve Bank in relation to "invisible" remittances sought to achieve the same objective.

The administration of a complex control system of this nature presented many problems, especially in the early stages. For example, it was found that the import payments, not only for licensed goods but also for goods ordered before the licensing system started, were likely to exceed the overseas funds available, and during 1939 it was necessary to introduce a system of "exchange authorities" authorising the banks to make remittances for imports in specified periods. In this way payments were spread over several months. Improvements in export receipts early in 1940 made it possible to abandon the spreading of payments, but the system of exchange authorities was retained.

In September, 1939, at the outbreak of war, New Zealand already had in operation a fairly complete control over imports and foreign exchange, so that little immediate change was necessary in the rules and procedures. The need for making the most effective use of the country's foreign exchange resources was of course increased, because of the additional need to allow for defence expenditure. There was also a new understanding, consequent on the formal establishment in September, 1939, of the sterling areas as an administrative unit under the United Kingdom ex-

change control regulations, whereby members of the sterling area ensured that their rules and procedures did not conflict with those of the United Kingdom. Such voluntary co-ordination of policies was—and still is—an essential means to the efficient working of sterling area exchange controls.

In 1940 the system of exchange control in New Zealand was completed by the "Finance Emergency Regulations", first issued in April but expanded and revised in June. Previously there had been no control over privately held foreign currency and securities, so that dealings in these could and did take place on a free market at exchange rates ranging up to about £N.Z.140=£Stg.100. (The official rate was then £N.Z.125=£Stg.100.) The Finance Emergency Regulations, *inter alia*, prohibited this free market by—

(a) requiring New Zealand residents holding any foreign currency to offer it for sale to the Reserve Bank;

(b) requiring New Zealand residents owning bank and other balances outside New Zealand to offer them to the Reserve Bank;

(c) requiring holders of any overseas securities to furnish a return of them to the Reserve Bank and not to sell, transfer, or create a charge on them without the Bank's authority;

(d) placing all transactions in foreign exchange under control;

(e) forbidding the use of any exchange rates other than the official ones.

(Authority to control transactions in this way was given to the Minister of Finance, who in terms of the regulations delegated it to the Reserve Bank.)

The essential features of the exchange and import control system which operated from June, 1940 to early 1950 without significant change, can be summarised as follows:—

1. Overseas currency receipts on account of exports had to be sold to the Reserve Bank or its agents, the trading banks.
2. All remittances from New Zealand were subject to the control of the Reserve Bank, with the trading banks acting as its agents.
3. Statutory control over private holdings of foreign securities and currencies, whether held at the time control was introduced or acquired later.
4. Rules and procedures in respect of transactions with countries outside the sterling area were based on those applicable in the United Kingdom.

The changes which have occurred in the net overseas assets of the New Zealand banking system as at the last balance day in December of each year since 1938 are shown in the table below:—

(£N.Z. millions) **NET OVERSEAS ASSETS**

1938	7.6	1945	99.3
1939	16.4	1946	108.4
1940	25.7	1947	80.2
1941	27.8	1948	66.1*
1942	43.5	1949	59.7
1943	46.3	1950	73.0
1944	57.4	1951	81.8

*In August, 1948, the N.Z. currency was revalued upwards by 25 per cent to parity with sterling.

The steady recovery in the level of net overseas assets during the war was due to the favourable prices received for our exports under contract to the United Kingdom, to the special efforts made to increase exports, to the earlier receipt of payment for exports under contract with the United Kingdom, to the expenditure of United States forces in New Zealand, to the operation of exchange and import controls, and to the difficulty in obtaining supplies of goods from overseas. The end of the war found New Zealand with net overseas assets at abnormally high levels, a figure of £119.5 million being reached in February, 1947. This level was not long sustained, however, as the Government's debt domiciled in the United Kingdom was reduced during the financial year 1945-46 by £38.6 million and again in 1947-48 by £11.3 million. In 1947 a gift of £N.Z.12.5 million was made to the United Kingdom. In August, 1948, the New Zealand pound was revalued to parity with sterling, thereby reducing by about £20 million the value (in New Zealand currency) of the net overseas assets. All these factors, together with the continuation of a high level of demand for imports, made it necessary to defer any serious consideration of a substantial relaxation of exchange and import controls during the immediate post-war years. However, export proceeds continued to rise and it was possible to issue import licenses and exchange permits much more generously. To have removed controls altogether at that time would have meant a quick depletion of overseas assets, the real value of which was already reduced by price increases.

Early in 1950 a new Government, intent on removing controls wherever practicable, began the process of relaxing exchange and import controls, helped in its task by rising wool prices. The main changes since then have been:—

1. In March, 1950, control over sterling area currency and securities privately held by New Zealand residents was abolished. Dealings in these were thus permitted in a free market, but the regulations still required that the official rates of exchange should be used, and that proceeds of sale of exports should be sold to Reserve Bank or its agents.
2. In April, 1950, the Government set up an Import Advisory Committee to examine the import licensing system, to recommend improvements in its administration, and to recommend a schedule of licenses for 1951. This temporary Committee was later replaced by the present Board of Trade.
3. In May, 1950, the Government announced that funds freed from control in March (see paragraph 1 above) could be used to import goods under "no-remittance" licenses, but such licenses would normally be available only for those classes of goods for which ordinary licenses were being granted. In the subsequent months considerable quantities of goods were obtained under the "no-remittance" licenses, especially motor cars.
4. The Import Licensing Schedule for 1951, issued on 31st July, 1950, freed from control a substantial list of items provided they were obtained from countries other than those listed in a schedule. The scheduled countries for this purpose included all the dollar and other hard cur-

rency countries, those behind the "Iron Curtain" and a few others, but Switzerland and Western Germany were later removed from the list when they joined the European Payments Union. Licenses for items remaining under control (other than licenses on a schedule country) are available for importing goods from any country other than a scheduled country.

5. As from 1st August, 1950, the trading banks were authorised to make remittances in respect of imports without exchange authorities. New arrangements were made for ensuring that remittances were made in the approved manner and for the correct amount. This change simplified the administrative work of exchange control.
6. From time to time the number of items freed from import control if obtained from non-scheduled countries has been increased, so that now about two-thirds of private imports are freed. This is illustrated in the following table:

(£N.Z. thousands) **PAYMENTS FOR IMPORTS**

	1950	1951			
	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Private Imports					
(a) Licensed	37,841	23,418	13,961	20,764	23,403
(b) De-controlled	683	14,865	21,523	33,478	48,127
(c) Other	286	161	205	585	748
Government Imports	4,698	6,474	3,479	3,800	5,163
TOTAL IMPORTS	**43,510**	**44,918**	**39,168**	**58,627**	**77,441**

Prospects

The relaxation of exchange and import controls which has occurred so far in New Zealand has been made possible mainly by the abnormally high prices received for wool. Receipts from other exports have also increased, but not to any abnormal extent. If wool prices had not risen as they did, little relaxation would have been possible. This fact is demonstrated in the following table:—

(£N.Z. millions)

Calendar Year	Receipts from Exports		Payments for Imports
	Wool	Other	
1949	43.8	95.4	126.6
1950	84.6	110.0	162.8
1951	125.0	128.8	220.2

Now that wool prices are much reduced (though still very satisfactory) the overseas funds available to spend on imports are correspondingly reduced. Though the present Government desires to remove exchange and import controls as fully and as quickly as is reasonably practicable, the question of further relaxations must be considered in the light of changing circumstances. This conclusion is reinforced by the findings of the Commonwealth Finance Ministers' conference in London in January, and also by the fact that the removal of further imports from licensing control cannot proceed far without depriving many local manufacturing industries of the protection they have had for 13 years. This problem is now under consideration by the Board of Trade.

XIII - EXCHANGE CONTROL IN NEW ZEALAND

In any situation in which the demand for foreign currency at fixed rates of exchange exceeds the supply, so that a rationing system becomes necessary, it is important that the overseas funds available to the controlling authorities should be as large as possible. This means, as a minimum, that all proceeds from the sale of exports should be sold to the banking system: it may also mean (depending on the seriousness of the situation) that all "invisible" receipts of overseas currencies should similarly be mobilised, and that the authorities should have power to control the disposal of overseas currency and securities privately held at the time the controls are introduced. As a last resort, the authorities may have to acquire such private assets compulsorily.

Proceeds of Exports

New Zealand's foreign trade is carried on almost solely in terms of foreign currency, usually sterling. Normally, exports are invoiced in terms of foreign currency, and the sale of those exports results directly in foreign currency being acquired by the exporter, who sells it to his local trading bank in return for payment in New Zealand currency. It was not (prior to exchange control) a normal practice for exporters to retain overseas the proceeds of sale of their goods; nor did the overseas buyers maintain bank balances in New Zealand out of which to pay for their purchases.

Dairy produce, meat, and a few minor products now provide exceptions to this general rule. They are sold for export by official marketing agencies (the Dairy Products Marketing Commission and the Marketing Department) both of which keep their bank accounts at the Reserve Bank and not at the trading banks. The proceeds of these exports thus accrue to the Reserve Bank directly.

All other New Zealand exports are subject to the Export Licenses Regulations, 1938, and must therefore be covered by an export license issued by the Customs Department. There are three types of export licenses:—

1. ***A General License*** is a license to export goods from a specified port or ports, during a specified period. It may apply to all kinds of goods or be limited to specified kinds of goods.
2. ***A Particular License*** is a license to export goods specified therein, by a specified ship.
3. ***A Purchaser's License*** is a license to export goods granted when funds in payment for permitted exports have already been made available to the Reserve Bank, or to the trading banks as the agents of the Reserve Bank.

The condition under which General and Particular

Licenses are issued is that the relative shipping documents and also bills of exchange, if any, must be delivered to a trading bank (specified in the application for a license) in New Zealand and that the net overseas proceeds of the sale of the goods must be received by that bank as agent for the Reserve Bank. If no invoice accompanies the documents sent overseas, the New Zealand exporter must in due course furnish the trading bank with a statement as to the sale of the goods and the amount of proceeds.

The Reserve Bank receives from the Customs Department the lists of all Export Licenses granted and also receives from the Collector of Customs at each port a record of all goods exported from that port.

When payment for goods is received, the trading bank fills in a "Memorandum of Receipt" giving details of the goods, showing the amount of foreign currency received and the country of origin of the funds (e.g., sterling from France). The "Memorandum of Receipt" fulfils a double purpose. It provides the basis for a statistical analysis of our receipts of foreign currency; and the information it contains is checked against the data of physical exports supplied by the Customs Department, thus ensuring that full payment in the appropriate currency is received for all exports. Any significant discrepancy is investigated. The trading banks have instructions as to the method by which payment is to be received, and since all documents relating to exports have to be negotiated through banks, evasion and concealed capital export are minimised.

Exporters are not allowed to retain any part of the foreign currency proceeds of sale of their goods in order to pay for any imports they may desire. (There are a few minor exceptions to this rule.)

The intention of the export licensing system is not to restrict exports in any way, but to ensure—

(a) that the full value of the exports in terms of foreign currency becomes available to the banking system;

(b) that payment for goods sold in hard currency areas is received in hard currency and not in soft;

(c) that there is no concealed export of capital through under-statement of the true value of the goods. For example, an exporter is not allowed to acquire £1,000 sterling for his own use by stating that the value of goods sold in United Kingdom is £5,000 when in fact it is £6,000.

Other Receipts and Returns of Non-sterling Currency

The Finance Emergency Regulations (No. 2) of June, 1940, in Regulation 6 (as amended in March, 1950), require every person ordinarily resident in New Zealand who holds or acquires any non-sterling currency or a right to receive non-sterling currency to offer it for sale to a bank in New Zealand. This rule applies to bank-notes or other currency, postal notes, promissory notes, and free bank deposits. Any such non-sterling currency not actually sold to a bank has to be reported to the Reserve Bank and offered for sale. Fixed deposits have to be reported to the Reserve Bank but not offered for sale. Any non-sterling currency or fixed deposit to which this regulation applies must not be disposed of (other than by way of repatriation through a New Zealand bank) except with the permission of the Reserve Bank.

(Before 9th March, 1950, this regulation applied also to sterling area currencies. Now "invisible" receipts and private holdings of sterling area currency are free from control.)

The right of the Reserve Bank to acquire non-sterling currencies offered to it under this regulation has not been exercised, and is not likely to be exercised except in a really serious crisis. If acquisition is ever resorted to, the price paid for the currencies shall be fixed by the Minister of Finance, having regard to current official rates of exchange.

Whenever banks in New Zealand receive foreign currency other than from the sale of exports, they complete a "Memorandum of Receipt" (as for exports) giving the details, and forward these memos monthly to the Reserve Bank for statistical purposes.

Non-sterling Securities

Regulation 7 of the Finance Emergency Regulations, 1940 (No. 2) as amended in March, 1950, provides that non-sterling securities owned by persons ordinarily resident in New Zealand are to be declared to the Reserve Bank by their owners, and are not to be sold or transferred without the prior consent of the Reserve Bank. (Before March, 1950 this regulation applied also to sterling area securities, but these are now free from control.) The Reserve Bank has power to acquire the non-sterling securities concerned, but has not yet exercised this right.

Import Licensing

The Import Control Regulations, 1938 prohibit the import of goods into New Zealand except—

(a) pursuant to a license granted by the Minister of Customs;

(b) pursuant to an exemption granted by the Minister of Customs.

Exemptions under (b) above have been issued authorising imports by the Government or on behalf of the Government, and also *bona fide* gifts and goods not exceeding £N.Z.10 in value imported by post by persons for their own use and not for the purpose of sale or business. From the beginning of 1951 several large groups of imports have been freed from licensing control if obtained from countries other than "Scheduled Countries"—the latter including the dollar countries, those behind the "Iron Curtain", and a few others. The intention is to increase the range of commodities thus exempt, as far as currency conditions and the needs of local industries permit. At present about two-thirds of the goods coming into New Zealand are not subject to licensing.

Several weeks or months before the commencement of a licensing period (normally a calendar year) the Customs Department issues a schedule which sets out the basis on which licenses will be issued (for goods still subject to licensing). Thus licenses for imports of a particular commodity would be allowed up to a specified percentage of licenses issued for such imports in a base period (usually but not always the preceding year). In the case of imports from the United States and Canada no specified basis is set out, each application being treated on its merits.

Each license states the importer's name, the nature of the goods, the tariff item, the value (expressed c.i.f.), the country of origin, and the period during which the license can be used.

Payment for Imports

The trading banks are authorised to make remittances in payment for imports provided—

(a) they have first sighted the relative shipping documents and invoices. In some few cases "clean payments" are allowed—i.e., payments made without the appropriate shipping documents being sighted. Special provision is made to ensure that the documents are sighted in due course;

(b) they hold a copy of the relative import license (if the goods are still subject to license); and

(c) they are satisfied that the amounts being remitted and the country to which remittance is to be made are substantiated by the documents produced as evidence of importation.

The above rules are necessary to ensure that remittances are not being used, without approval, for purposes other than in payment for imports, that payment is made in the appropriate currency, and that remittances do not include concealed capital exports.

For each remittance the trading banks complete a "Memorandum of Remittance" which provides a description of the transaction. These are sent monthly to the Reserve Bank for statistical purposes.

In addition to the above procedures, on 31st March, 1952, an exchange allocation scheme covering remittances for imports in 1952 (as outlined on page 33), was announced.

Payments Other than for Imports

The Reserve Bank administers a system under which those wishing to remit money overseas for payments other than for imports must apply through their trading banks for a permit from the Reserve Bank. In respect of each transaction, a "Memorandum of Remittance" is completed (as for imports) by the trading bank, and these also are sent monthly to the Reserve Bank for statistical purposes.

Ancillary to the permit system, the trading banks may make remittances, within the sterling area only, under discretionary powers granted by the Reserve Bank. Under this arrangement, branches of the banks may remit for their customers, without reference to the Reserve Bank, for certain specified purposes up to specified amounts. Items covered by this discretionary authority include travellers' expenses, legacies, repayment of debts, insurance premiums, current income, pensions, family maintenance, and small payments of a recurring nature.

In all cases not covered by these discretionary limits, remittance through a trading bank is not allowed except in accordance with a permit issued by the Reserve Bank.

Small amounts may be remitted overseas through the Post Office by means of Money Orders or British Postal Orders. The Post Office has a small discretionary limit applicable to the sterling area only. The purposes for which remittance may be made by this method are strictly limited. Special arrangements are also made with Thomas Cook & Sons Ltd., the world-wide travel agency, concerning the supplying of foreign currency and travellers' cheques to *bona fide* travellers.

The essential features of the permit system are as follows—

(a) For payments which are of a contractual nature, remittance is approved to *any* country, provided the contract was entered into (i) prior to the introduction of controls or (ii) with the approval of the Reserve Bank.

(b) Payments within the sterling area are not restricted with the exception of capital exports by New Zealand residents, travel allowances, and a few minor items.

(c) Remittances not of a contractual nature to countries outside the sterling area are "controlled". This means that each application is treated on its merits—e.g., the urgency or importance of the remittance, and the hardness of the currency concerned. Remittances to hard currency areas are subject to very strict scrutiny.

(d) Remittances of interest, dividends, and profits are permitted to any country.

(e) For travel purposes, reasonable remittances are approved having regard to the purpose of the travel, the hardness of the currency concerned, and the cost of living in the country to be visited.

(f) All capital movements are strictly controlled.

Applicants who desire to use their own holdings of non-sterling currency to make payments overseas are normally permitted to do so provided remittance from New Zealand would have been allowed for the same purpose. Overseas funds acquired from sources other than exports may also be invested in securities domiciled in the same country.

Persons resident outside New Zealand but within the sterling area are (with a minor exception) permitted to withdraw funds from New Zealand. Capital withdrawals by non-residents of the sterling area are allowed only in a number of specified circumstances.

Other uses of blocked funds are sometimes allowed—usually for compassionate and hardship purposes. Such uses are not allowed if the holder is able to remit from his own country.

Export and Import of Money

The law concerning the export and import of money from and to New Zealand is contained in the Finance Emergency Regulations, 1940 (No. 2) supplemented by the Customs Import Prohibition Order, 1941 (No. 1) and the Customs Export Prohibition Order, 1941 (No. 1) (Statutory Regulations 1941-93 and 94). For the purpose of these regulations "money" includes bank-notes and other currency, postal notes, money orders, promissory notes and bills of exchange.

If money is to be exported through the post it should be accompanied by a form showing that the export has been approved by the Reserve Bank or its agents. There are no exceptions to this rule.

Travellers leaving New Zealand may take with them, without approval, up to £10 in Reserve Bank notes and £5 in silver if they are travelling to the United Kingdom. If going elsewhere than to the United Kingdom the limit is £5 in Reserve Bank notes and £2 in silver. In all cases the Reserve Bank notes must be in denominations of 10/- or £1. Any other money in whatever form taken out by travellers must be authorised by a bank. All travellers 16 years or

over must, when about to depart from New Zealand, declare all money taken with them whether or not it is covered by an approval form.

In general the importation of money into New Zealand is not limited, but the following exceptions apply:—

1. The limit on the importation of silver coin is £2 for each person arriving.
2. The importation of Bank of England notes and of notes issued by banks in Scotland and Northern Ireland is prohibited, for amounts in excess of £20.

Dealings in Non-Sterling Securities

All sales of, or dealings in non-sterling securities must have the prior approval of the Reserve Bank. If the sale has been approved and subsequently completed, advice of the sale is given to the Reserve Bank. If the proposed sale is to another resident of New Zealand, permission is normally granted. If the proposed sale is to a non-resident of New Zealand, the proceeds of sale in the foreign currency nominated in the security must either be sold to a New Zealand bank or they may be re-invested or retained in the same country. Documents sent out of New Zealand for the purpose of achieving transfer of ownership must be accompanied by an approval form. Also, if the securities are taken out of the country by travellers, an approval form is required.

The Reserve Bank does not normally agree to the remittance of funds by New Zealand residents for the purpose of taking up new shares to which they may be entitled in overseas issues. A number of alternative methods of taking up these "rights" are available.

The objectives of the control over non-sterling securities may be summarised as follows:—

1. To prevent capital remittances to countries outside the sterling area.
2. To prevent evasion of the rules governing current transactions.
3. To make it possible for the Government to acquire private holdings of non-sterling securities should this action be necessary in an emergency. Power to compel the sale to the Government of non-sterling securities is contained in Regulation 7 of the Finance Emergency Regulations, but has not yet been used.

Sterling Area Arrangements

In the New Zealand exchange control system rules are laid down as to the currency in which payments for overseas transactions must be received or made. Thus, for example, exports to Italy must be paid for in sterling from an Italian account, from any transferable account, or from an American account. This set of rules is identical with that adopted by the United Kingdom and it has its origin in the arrangements governing the sterling area and the bilateral agreements which the United Kingdom has entered into with a large number of non-sterling countries. Thus our exchange control conforms to the United Kingdom system of American accounts, bilateral accounts, transferable accounts, etc.

Exchange Allocations for Imports, 1952

In recent months the overseas balance of payments position of New Zealand changed rapidly from a large surplus to an increasing deficit. For the twelve months ended June, 1951 there was a surplus of £39.1 million; for the calendar year, 1951 the surplus was only £16.1 million; for the twelve months ended March, 1952 there was a deficit of £16.4 million. It was becoming increasingly apparent that, despite a probable reduction in payments for imports below the abnormal level of the months since last August, a substantial deficit would occur during 1952 which would reduce net overseas assets well below the figure which could be regarded as adequate in present circumstances. Therefore, on 31st March the Reserve Bank issued the following statement:—

"The Reserve Bank has been considering further ways and means of ensuring that the demands on our overseas funds to pay for imports do not become too heavy as the year progresses.

"Three of the causes which make additional safeguards necessary are:—

"1. The recent fall in prices of wool, hides and skins, seeds, and other farm products, and a consequent reduction in estimated export receipts;

"2. The recent heavy restrictions imposed by several Commonwealth countries on imports from other countries in the sterling area.

"This means a much greater availability of goods, which are liable to be diverted to New Zealand to a much greater extent than we can afford to absorb.

"3. The abnormally high level of private imports into New Zealand, which during the past few months have been arriving at the rate of more than £280 million a year.

"This excessive rate of importing is regarded as being temporary and not chronic, but specific measures are needed to prevent our overseas reserves being depleted to a level below what can be regarded as reasonably safe.

"After consultation between the Government, the Reserve Bank, the Board of Trade, the Customs Department, the Department of Industries and Commerce, and the trading banks, it has therefore been decided to take the following action forthwith:—

"1. Except with the approval of the Reserve Bank, the trading banks have been advised not to sell to any importer, during the whole of 1952, more than 80 per cent of the amount of exchange sold to that importer during 1950. The 80 per cent includes payment for both licensed and unlicensed imports from all countries. It also includes payment for goods brought or sent into New Zealand on consignment.

"2. Reference must be made to the Reserve Bank through the trading banks in cases where importers require more than 80 per cent.

"Decisions will be made, in consultation with the Board of Trade, the Department of Industries and Commerce, and the Customs Department, according to a scale of priorities which will take the following factors into account:—

"(a) Essentiality of the goods in question.

"(b) Whether or not the goods are already in over-supply in New Zealand.

"(c) Firm commitments entered into before 1st April, 1952.

"(d) Import licenses held by the importer.

"(e) Any other special circumstances, which will be dealt with on their merits.

"3. To ensure speedy and orderly handling of applications, the banks are being supplied within a few days with application forms.

"Importers who require an allocation should lodge their applications as soon as possible. In the interim, to prevent any avoidable interruption to the handling of current transactions, the banks are being authorised to meet the immediate overseas commitments of importers provided they are satisfied that each transaction is in the normal course of business and has not been speeded up in any way.

"4. To enable the banks to obtain the necessary information more quickly than is possible from their own records, the application forms will be accompanied by a circular requesting importers to supply the following information:—

"(a) Total value in New Zealand currency of all orders placed before 1st April, 1952, and accepted overseas and not yet delivered. This covers remittances to pay for imports during each of the remaining three quarters of 1952 and the first two quarters of 1953.

"Where definite information is not available as to when shipments will be made, the closest possible estimate should be given.

"(b) Total amount remitted to pay for imports in 1950 and 1951 respectively.

"5. In a number of cases reference to the Reserve Bank may be necessary, even though the total allocation which the importer wants for 1952 may be less than 80 per cent of his 1950 remittances; for example, reference would need to be made, in terms of the Reserve Bank's announcement of the 17th December, 1951, if an increase in the importer's overdraft limit would be involved.

"It should be clearly understood that the basic allocation of 80 per cent does not confer on any importer the **right** to obtain bank accommodation to pay for the exchange; this means that if, for any reason, an importer's bank is not willing to grant him increased accommodation, there is nothing in the present arrangement that requires the bank in question to grant the accommodation.

"6. Importers should not place fresh orders overseas without first consulting their bank managers.

"7. Any importer who does not use his full allocation this year will not thereby be penalised on any future occasion.

"The effect of these measures on imports for 1952 can be assessed from the fact that payments for non-government imports in 1950 were £140 million, and in 1951 were £201 million. On present indications an amount of up to between £170 million and £180 million can be made available for the whole of 1952 to pay for non-government imports.

"To enable this to be done the Reserve Bank is prepared to supplement overseas receipts by a reasonable amount from its reserves of foreign exchange.

"In doing so, the Bank must keep in mind its statutory duty to—

"'maintain reserves which, in the opinion of the Board of Directors, will provide a reasonable margin for contingencies, after taking into account prospective receipts and disbursements of overseas funds, and having regard to the economic position within New Zealand.'

"The Reserve Bank regards the introduction of exchange allocations as a temporary measure to meet a particular situation, to be abolished as soon as they have served their purpose.

It is important that the above measures should be seen in their proper perspective.

"They are designed not only to ensure that our financial structure will pass through 1952 with its basic soundness unimpaired, but also to ensure, so far as humanly possible that importers and consumers alike will not be called upon to suffer any undue stringency in overseas exchange during 1953."

(***Note:*** The above description of the exchange control system in New Zealand relates to present circumstances. Rules and procedures are changed from time to time, and all major changes will be recorded in the "Bulletin". However, minor changes will also occur, and anyone wanting to engage in foreign exchange transactions should first consult his trading bank rather than accept these brief articles on the subject as being authoritative at all times.)

European Payments Union

The outbreak of war in 1939 temporarily put an end to the efforts which had been made during the preceding twenty years to restore the exchange stability, the multilateral convertibility of currencies, and the free movement of goods which had characterised the period before 1914.

When hostilities ceased in 1945 and European Governments could concentrate more fully on the problem of restoring their shattered productive and transport equipment, and of stabilising their disorganised economies, the difficulties they encountered proved greater than had been anticipated. In particular, though industrial production recovered steadily, there was slow progress in solving the problem of their external payments. The capacity of European countries to export was severely handicapped by the

physical destruction caused by war, the shortages of materials and equipment, and monetary inflation which both increased the local demand for goods otherwise exportable and reduced the competitive power of export industries in world markets. At the same time there was an expanded demand for imports of all kinds, also the result of physical destruction and inflation. It was hard enough for many countries to balance their total external receipts and payments; it was very much harder to achieve a balance with the dollar countries. Hence the intensification (in the post-war period), of the dollar problem, and the need for special measures, in the form of U.N.R.R.A., assistance from the International Monetary Fund and Bank, dollar loans and grants, and finally Marshall Aid.

For the European countries the problem was not only one of achieving a dollar balance. Trade *within* Europe was also disrupted by the effects of war. Many goods could no longer be obtained from normal sources of supply; many former markets were closed. Political controversies placed a barrier to normal trade between Eastern and Western Europe. Payments between countries would not balance, and it was not possible to offset deficits with one country against surpluses with others, since European currencies were not freely convertible into one another. A complication arose because the physical burden of war had not affected all countries equally, Switzerland and Belgium in particular being relatively well placed and their financial policies being such as to make their currencies hard. The result was the adoption or intensification of import and exchange restrictions which discriminated between other countries, and the use of bilateral trade and payments agreements designed to avoid severe deficits. No country wanted to acquire, as a result of a surplus in the balance of payments, large sums in inconvertible currency, or to incur deficits which might have to be settled in gold or dollars. The bilateral arrangements were designed to prevent the complete collapse of trade, but they also tended to divert trade into uneconomic channels.

It is true that some progress was made in restoring sterling to its former position as an international currency, the system of "transferable accounts" being an important step in this direction; and in 1947 an attempt was made, though unsuccessfully, to make current earnings of sterling freely convertible into dollars. Also the United States Government (by means of loans and grants), the International Monetary Fund, the International Bank, and U.N.R.R.A. have done much to solve the dollar problem and facilitate economic recovery in Europe. But the tangle of exchange and import restrictions on trade within Europe remained as a major impediment to progress.

One of the chief objectives of Marshall Aid and the European Recovery Programme has been to break down the barriers to trade within Europe; for so long as these remained the progress of Europe towards independence of special dollar aid has been hindered. But before progress could be made something had to be done to make currencies more freely interchangeable, so that surpluses could be offset against deficits and the fear of losing monetary reserves removed. A first move in this direction was made in October, 1948, when an Intra-European Payments Scheme was adopted by the Organisation for European Economic Co-operation. The Scheme was only a very limited success as it was still on a narrowly bilateral basis and did little to increase the interchangeability of currencies or to break down exchange restrictions. In July, 1949, it was revised but still it was not satisfactory.

On 7th July, 1950, the Council of O.E.E.C. in Paris approved a new and much better scheme, to be known as the European Payments Union, and to take effect from 1st July. The members of the Union are—subject to ratification of the Agreement by their Governments—Austria, Belgium-Luxemburg, Denmark, France, Western Germany, Greece, Iceland, Italy, Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, and the United Kingdom.

The purpose of E.P.U. is to facilitate the "liberalisation" of European trade by a system of multilateral settlement of surpluses and deficits between participating countries. This means that the members no longer need to worry about their balance of payments with other members individually, but only with their surplus or deficit with them all collectively. An accumulated surplus may lead to the receipt of gold from the Union, an accumulated deficit may lead to the payment of gold to the Union but in general the question of gold settlements is pushed further into the background than in the past.

Several very important results are anticipated:—

(1) All currently-earned currency of member countries (held by the central banks) will be, in effect, mutually convertible.

(2) The distinction between hard and soft currencies will be abolished as far as participating countries are concerned. This means that each member country's currency can be treated as soft, unless a member is so far in deficit with all other members combined that it is required to pay gold to the Union. In that case the member concerned (and it alone) may have to treat all other members' currencies temporarily as hard.

(3) The justification for discrimination between member countries in the application of exchange and import restrictions will no longer exist.

(4) Member countries will be able to proceed with much greater confidence to the progressive removal of restrictions on Intra-European trade.

(5) With a greater degree of international competition and with increased stimulus to productive efficiency, the whole economy of Europe will be strengthened and its dependence on the dollar area reduced.

While New Zealand is not a member of either O.E.E.C. or the European Payments Union, we are indirectly involved in that our exchange transactions with the participating countries will affect the United Kingdom surplus or deficit with the Union. Also we shall benefit from our ability, already provided for in the import licensing procedures for 1951, to treat all E.P.U. members as soft currency countries.

It is too early yet to assess the full effects of the operation of E.P.U., but if present expectations are realised it can safely be said that the establishment of the Union is an event of major importance in international financial affairs.

The basis of the scheme lies in the fact that, as a result of the settlement of financial transactions be-

tween countries, central banks hold varying amounts of credit balances at the central banks of other countries. For example, if payments in sterling to France exceed sterling payments by France, the balance in the Bank of France's account at the Bank of England increases; or if Norway has an adverse balance of transactions with Belgium, the Bank of Norway's funds at the National Bank of Belgium decline. In recent years the flow of trade within Europe has been severely hindered by the fact that the central bank balances have not been freely convertible into other currencies, owing to the existence of many restrictions and bilateral arrangements.

The principal achievement of the European Payments Union will be the free transferability between members of all currently-acquired balances of each other's currency. Every participating country will periodically be able to use funds acquired as a result of a surplus with one member to meet deficits incurred with other members of the Union. At each periodic settlement—every two months until the end of 1950 and thereafter monthly—the central bank of each member will notify the Bank for International Settlements at Basle (acting as agent for E.P.U.), the balance in the accounts open on its books in the name of the central bank of each of the other members. The agent will then calculate from the changes in these balances the cumulative net deficit or surplus of each member *vis-à-vis* all the others combined, and this will be recorded in the books of the Union. Countries showing a net surplus will receive part payment from the Union in gold and the balance will remain as a credit to the Union. Deficit countries will be required to make part payment in gold to the Union and the balance will be received as a credit from the Union. Interest will be payable on the credits received and granted. The proportion of gold payments to credits will be calculated by the B.I.S. according to a sliding scale designed to discourage the accumulation of large deficits or credits. For each member a quota has been allotted, not in the form of a cash subscription, but as an indication of the limits within which each participating country may borrow from, or lend to, the Union. The amount of credit any member may extend to, or receive from the Union is limited to a maximum of 60 per cent of its quota, through the operation of the sliding scale of gold payments and credits. If, after successive settlements, a member has accumulated a net surplus with the Union equal to its quota, it will have thus received 40 per cent of the amount in gold and the remainder will have been granted in loans. Should a member accumulate a deficit relative to the Union equal to its quota, it will have paid 40 per cent of the amount in gold and received the remainder by way of loan. Should a debtor's net cumulative position relative to the Union rise above its quota, the excess will, unless the organisation decides otherwise, be settled fully in gold.

The quotas have been calculated as approximately 15 per cent of each country's aggregate visible and invisible current transactions with other members in 1949. The quotas, and all the book-keeping records of the Union, will be expressed in a unit of account equal to 0.88671 grams of fine gold, the equivalent of the present U.S. dollar. The United Kingdom has the largest quota, 1,060 million units, while the quota of France is 520 million, Belgium-Luxemburg 360 million, Netherlands 330 million, and Germany 320 million. The quotas of all members total 3,950 million units.

Should a member remain a persistent debtor or creditor its position will be examined with a view to recommending appropriate remedial action, such as the temporary suspension by a debtor of measures taken by it to liberalise trade or invisible transactions. As some members are likely to be creditors to the Union, and others debtors, a kind of "handicapping" system has been arranged whereby the potential creditors (United Kingdom, Belgium-Luxemburg, and Sweden) start off with debit balances with the Union, and six potential debtors start off with credit balances. This serves to postpone even further the time when gold settlements will be required.

In the case of the United Kingdom the decision to make all sterling balances held by other members on 30th June, 1950, available for the settlement of net deficits with the E.P.U., could involve the United Kingdom in gold payments. That risk has been obviated by a special agreement under which the E.C.A. has underwritten any gold losses the United Kingdom may incur through other members drawing on their sterling balances.

This arrangement, and in fact the whole E.P.U. system, ensures that the position of sterling as an international currency is not endangered. Through the membership of the United Kingdom in the E.P.U. the new European system of multilateral trade and payments is linked to the large area within which sterling is already transferable. Accordingly there is no longer any need for members to discriminate between other members in the administration of import and exchange controls. Either all will be "hard" or all "soft" currency countries.

The resources of E.P.U. will include a working capital of $350 to $400 million to be made available in the form of free dollars by the E.C.A. out of the dollar aid appropriated by Congress for 1950-51. There will also be a fund, similarly provided, of between $200 and $250 million to assist any member experiencing special difficulty in meeting its obligations under the scheme.

In the formulation of the European Payments Union it was recognised that multilateral payments arrangements, though essential to multilateral trade, do not of themselves make it possible. Accordingly under the E.P.U. agreement, members have undertaken, as from 1st January, 1951, to avoid any discrimination in respect of imports of any products as between one member and another. In the main this policy of non-discrimination is also to apply to "invisible" transactions as from 1st October, 1950. Furthermore, O.E.E.C. nations are now required to remove import quota restrictions from 60 (instead of the previous 50) per cent of their private imports from other O.E.E.C. countries as a whole (based on 1949 imports). By the end of 1950 this figure must be increased to 75 per cent.

Initially the E.P.U. is expected to operate until 30th June, 1952, when the position is to be reviewed, but it has been so devised that after the termination of Marshall Aid the machinery will serve the needs of a trading area free from quantitative trade and exchange restrictions.

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